

MANAGEMENT'S DISCUSSION AND ANALYSIS

September 30, 2007

(Dollar amounts expressed in thousands)

This Management's Discussion and Analysis (MD&A) provides a narrative overview and analysis of the financial activities of the District of Columbia (the District) for the fiscal year ended September 30, 2007. This discussion and analysis should be read in conjunction with the basic financial statements and the related note disclosures. In addition, it is important to also read the Transmittal Letter, which begins on page 1, in conjunction with the MD&A.

OVERVIEW OF THE FINANCIAL STATEMENTS

The District's basic financial statements are comprised of three components:

- (1) *Government-Wide Financial Statements* - Exhibit 1-a, *Statement of Net Assets*, and Exhibit 1-b, *Statement of Activities* on pages 46 and 47 respectively, present information about the financial activities of the District as a whole. These two statements provide an overall view of the District's finances.
- (2) *Governmental Fund Financial Statements* - Exhibit 2-a, *Balance Sheet – Governmental Funds*, Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds*, Exhibit 2-c, *Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities*, and Exhibit 2-d, *Budgetary Comparison Statement* on pages 48, 49, 50, and 51, respectively, show the District's financial position at the end of the fiscal year and how governmental activities were financed during the current year.

Proprietary Funds – Exhibit 3-a, *Statement of Net Assets*, Exhibit 3-b, *Statement of Revenues, Expenses, and Changes in Fund Net Assets* and Exhibit 3-c, *Statement of Cash Flows* on pages 52, 53 and 54 respectively, show the changes in financial position and condition of the District's two major proprietary funds, the D.C. Lottery & Charitable Games Board and the Unemployment Compensation Fund, and its one non-major proprietary fund, Nursing Home Services. Proprietary funds account for the activities of District entities that charge customers fees for services provided.

Fiduciary Funds – Exhibit 4-a, *Statement of Fiduciary Net Assets* and Exhibit 4-b, *Statement of Changes in Fiduciary Net Assets* on pages 55 and 56 report activities for which the District acts exclusively as a trustee or agent for the benefit of entities or individuals external to the government.

Discretely Presented Component Units - The District currently has eight (8) component units. The financial data of the component units are reported separately from the financial data of the primary government: Exhibit 5-a, *Discretely Presented Component Units Combining Statement of Net Assets* on page 57 and Exhibit 5-b, *Discretely Presented Component Units Combining Statement of Activities* on page 58.

- (3) *Notes To The Basic Financial Statements* - Present additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements, and can be found on pages 60 through 113.

FINANCIAL HIGHLIGHTS

- In the government-wide analysis, assets exceeded liabilities, resulting in total net assets of \$2,977,667. The total net assets consists of *net assets invested in capital assets, net of related debt* of \$1,214,486, *restricted net assets* of \$1,644,856, and *unrestricted net assets* of \$118,325. The total government-wide net assets included \$2,559,328 generated by governmental activities and \$418,339 generated by business-type activities.
- There was an increase of \$469,198 over the previous year in the government-wide total net assets. This increase is attributable to a \$978,732 increase in total assets, which was offset by an increase in total liabilities of \$509,534. The increased collection of taxes and other revenues accounted for the majority of this increase. (See Table 1, *Net Assets as of September 30, 2007* on page 27.)

- The governmental funds reported a combined fund balance of \$2,789,580 which was an increase of \$299,958 over the previous year. The fund balance of the General Fund was \$1,494,000 or 53.6% of the combined fund balances, and represented an increase of \$58,858 over the previous year.
- \$1,135,459 of the General Funds fund balance is reserved for specific purposes: \$309,383 is legally set aside for emergencies and contingencies, and \$326,768 for bond escrow, with \$499,308 reserved for other purposes. \$358,541 of the General Fund's fund balance is unreserved with \$277,299 designated for specific purposes leaving \$81,242 undesignated.
- Total long-term debt related to notes and bonds increased by \$335,238, or 6.5%. There was a net increase of \$366,270 in general obligation debt and a decrease of \$(31,032) in other debt. (Table 4, *Outstanding Bonds and Notes at September 30, 2007*, page 36).

NEW GASB PRONOUNCEMENTS

The mission of the Governmental Accounting Standards Board (GASB) is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors, and users of those financial reports. GASB is one of the authoritative bodies that set accounting, auditing and financial reporting standards for state and local governments.

GASB Statement No. 43

Issued in April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans*. This Statement supersedes the interim guidance included in *Statement No. 26, Financial Reporting for Post Employment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach employed in this Statement conforms with the approach adopted in *Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* with modification to reflect variances between pension plans and other post employment benefits (OPEB) plans. Implementation of GASB Statement No. 43 requires footnote disclosures, schedule of funding progress and inclusion in Exhibit 4-a, *Statement of Fiduciary Net Assets* and Exhibit 4-b, *Statement of Changes in Fiduciary Net Assets* for FY 2007.

GASB Statement No. 45

In July 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related assets and liabilities, note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

GASB Statement No. 45 does not become effective for the District until FY 2008. The District plans to implement this Statement by the effective date.

GASB Statement No. 48

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. Governments sometimes exchange an interest in their expected cash flows from specific receivables or specific revenues, for immediate cash payments – generally, a single lump sum. This Statement establishes criteria that governments will use to ascertain whether the proceeds should be reported as revenue or as a liability. This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenue, including residual interests and recourse provisions. The requirements in this Statement improve financial reporting by establishing measurement, recognition, and disclosure requirements that apply to both governmental and business-type activities.

GASB Statement No. 48 does not become effective for the District until FY 2008. The District will implement this Statement during FY 2008.

GASB Statement No. 49

On December 1, 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement identifies the circumstances under which a government would have to estimate its expected outlays for pollution remediation, if it knows that a site is polluted. This Statement also requires state and local governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

GASB Statement No. 49 becomes effective for financial statements beginning after December 15, 2007, the District's FY 2009. The District will implement this pronouncement prior to its due date.

GASB Statement No. 50

In May 2007, GASB issued Statement No. 50, *Pension Disclosures*. This Statement provides new guidance and modifies the note and required supplementary information (RSI) required for other postemployment benefits (OPEB). The changes for the financial statement of pension plans include a requirement to present a schedule of funding progress as RSI even when a government uses the aggregate actuarial cost method.

GASB Statement No. 50 becomes effective for financial statements beginning after July 15, 2007, the District's FY 2008. This Statement will be implemented during FY 2008.

GASB Statement No. 51

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that intangible assets must possess the following characteristics: (1) lack of physical substance, (2) be non-financial in character, and (3) have an initial useful life extending beyond a single reporting period. The Statement further provides that recognition of intangible assets is only appropriate when they are either separable (e.g. can be sold, transferred, or licensed) or represent contractual or other legal rights, regardless of transferability or separability.

GASB Statement No. 51 becomes effective for financial statements beginning after June 15, 2009, the District's FY 2010. This District plans early implementation of this Statement.

GASB Statement No. 52

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estates Held as Investments by Endowments*. This Statement requires endowments to report their land and other real estate investments at fair value. Governments are also required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value.

GASB Statement No. 52 becomes effective for financial statements beginning after June 15, 2008, the District's FY 2009. The District plans implementation of this Statement during FY 2009.

THE DISTRICT'S FINANCIAL CONDITION

The District government's level of financial responsibility and performance can be measured in various ways. Below are some of the indicators of the District's improved financial position and condition:

- The total expenditures for the District were again within budget.
- The General Fund ended the year with a budgetary surplus of \$280,854. After deducting the use of fund balance released from restrictions and other adjustments required by generally accepted accounting principles (GAAP), the non-budgetary or GAAP surplus was \$58,858.
- The accumulated General Fund fund balance at September 30, 2007 was \$1,494,000.

- The required legal debt limitation allows the District to use up to 17.0% of its total revenues for debt service in FY 2007. However, the District's debt service cost was only 6.9% of total revenues, or about 40.6% of the legal limit.
- The District continues to allocate large amounts of funds for infrastructure assets.

Reporting the District as a Whole (Government-Wide Financial Statements)

The District, as a whole, reports all assets and liabilities using the *accrual basis of accounting*. This method of reporting is similar to the accounting method used by most private-sector companies. Under this basis of accounting, all of the current year's financial activities are taken into account regardless of when cash is received or paid. The governmental activities and business-type activities are presented in two separate columns and combined to show totals for the primary government. The *Statement of Net Assets* and the *Statement of Activities* are two statements that present information and activities that help the reader determine the overall financial condition of the District.

The District's current financial resources (short-term disposable resources) are reported along with capital assets and long-term obligations in the *Statement of Net Assets*. The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as *net assets*. This statement distinguishes between governmental activities, business-type activities and component units' activities.

The total net assets is the sum of three components: 1) *net assets invested in capital assets, net of related debt*, 2) *restricted net assets*, and 3) *unrestricted net assets*. Over time and accounting periods, changes in the District's net assets are indicators of its financial health. However, changes in population, property tax base, infrastructure condition and other non-financial factors must also be considered in assessing the overall financial health of the District.

The *Statement of Activities* presents information showing how the government's net assets changed from the last fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses reported in this statement also include items that will only result in cash flows in future fiscal periods, (for example, uncollected taxes and earned but unused vacation leave).

The *Statement of Activities* summarizes both the gross and net cost of the governmental activities and business-type activities. Governmental activities show the District's basic functional services while business-type activities reflect enterprise operations where fees for services are expected to cover all or most of the costs of operations, including depreciation. Program/functional expenses are reduced by program specific earned revenues, and by grants, that reduce net expenses for governmental and business-type activities. The District's general revenues (property, sales, income and franchise taxes) offset remaining costs, resulting in an increase or decrease in net assets.

Financial Analysis of the Government as a Whole (Government-Wide Financial Statements)

In fiscal year 2007, the combined total net assets increased by \$469,198. This increase is the combination of a governmental activities increase of \$445,302 and a business-type activities increase of \$23,896. See Table 2, *Change in Net Assets as of September 30, 2007*, on page 28. The increased collection of taxes and other revenues, particularly individual income and property taxes, accounted for the majority of this outcome. More efficient use of resources, including better expenditure management, also contributed to this positive result.

Restricted net assets are assets that are subject to use-constraints that are either: (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or, (b) imposed by law through constitutional provisions or by enabling legislation. In FY 2007, total restricted net assets increased by \$309,268, or 23.16%, consisting of an increase of \$282,058, or 28.56%, from governmental activities, and an increase of \$27,210, or 7.82% from business-type activities.

The Lottery and Charitable Games Control Board, an enterprise fund of the primary government, transfers substantially all of its net income to the District at the end of each fiscal year. In fiscal year 2007, the transfer was \$65,376, which was a \$8,424 decrease from last year. Please see Exhibit 3-b, *Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds*, on page 53.

Fund balances in the governmental fund financial statements will generally differ from net assets in the governmental activities of the government-wide financial statements due to the measurement focus and basis of accounting used in the respective financial statements.

- Fund financial statements focus primarily on the sources, uses, and balances of current financial resources and use the modified accrual basis of accounting.
- The government-wide financial statements focus on all of the District's economic resources and use the full accrual basis of accounting.

The total net assets of \$2,559,328 in FY 2007 represent an increase of \$445,302 from the FY 2006. The net increase was composed primarily of an increase of \$238,678 in invested in capital assets, net of related debt, and an increase of \$282,058 for other restricted net assets. The increase in net assets was due mainly to a significant increase in property taxes of \$272,327, an increase in income and franchise taxes of \$144,878, and an increase of \$184,280 for other taxes.

Table 1 - Net Assets for the year ended September 30, 2007

	Governmental activities		Business-type activities		Totals	
	2007	2006	2007	2006 Restated	2007	2006 Restated
Current and other assets	\$ 4,181,473	\$ 3,811,134	\$ 489,112	\$ 473,582	\$ 4,670,585	\$ 4,284,716
Capital assets	6,139,898	5,546,741	17,211	17,505	6,157,109	5,564,246
Total assets	10,321,371	9,357,875	506,323	491,087	10,827,694	9,848,962
Long-term liabilities	6,416,109	5,984,643	46,725	52,584	6,462,834	6,037,227
Other liabilities	1,345,934	1,259,206	41,259	44,060	1,387,193	1,303,266
Total Liabilities	7,762,043	7,243,849	87,984	96,644	7,850,027	7,340,493
Net assets:						
Invested in capital assets, net of related debt	1,197,275	958,597	17,211	17,505	1,214,486	976,102
Restricted	1,269,708	987,650	375,148	347,938	1,644,856	1,335,588
Unrestricted	92,345	167,779	25,980	29,000	118,325	196,779
Total net assets	\$ 2,559,328	\$ 2,114,026	\$ 418,339	\$ 394,443	\$ 2,977,667	\$ 2,508,469

Table 2 - Change in Net Assets for the year ended September 30, 2007

	<u>Governmental activities</u>		<u>Business-type activities</u>		<u>Total</u>		
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006 Restated</u>	<u>2007</u>	<u>2006 Restated</u>	<u>Variance</u>
Revenues:							
Program revenues:							
Charges for services	\$ 334,977	\$ 325,413	\$ 288,673	\$ 295,545	\$ 623,650	\$ 620,958	\$ 2,692
Operating grants and contributions	2,309,495	2,155,035	18,358	14,825	2,327,853	2,169,860	157,993
Capital grants and contributions	130,557	119,715	-	-	130,557	119,715	10,842
General revenues:							
Property taxes	1,545,325	1,272,998	-	-	1,545,325	1,272,998	272,327
Income and franchise taxes	1,736,361	1,591,483	-	-	1,736,361	1,591,483	144,878
Sales and use taxes	1,056,780	1,004,471	-	-	1,056,780	1,004,471	52,309
Other taxes	800,966	668,995	90,117	95,888	891,083	764,883	126,200
Non tax revenues	580,845	504,389	21,936	20,031	602,781	524,420	78,361
Total revenues	8,495,306	7,642,499	419,084	426,289	8,914,390	8,068,788	845,602
Expenses:							
Governmental direction and support	787,392	574,097	-	-	787,392	574,097	213,295
Economic development and regulation	509,874	391,203	-	-	509,874	391,203	118,671
Public safety and justice	1,264,715	1,124,896	-	-	1,264,715	1,124,896	139,819
Public education system	1,589,652	1,486,112	-	-	1,589,652	1,486,112	103,540
Human support services	2,992,805	2,967,372	-	-	2,992,805	2,967,372	25,433
Public works	481,702	351,917	-	-	481,702	351,917	129,785
Public transportation	198,484	187,615	-	-	198,484	187,615	10,869
Interest on long-term debt	281,918	269,725	-	-	281,918	269,725	12,193
Lottery and games	-	-	192,336	193,907	192,336	193,907	(1,571)
Unemployment compensation	-	-	99,920	102,749	99,920	102,749	(2,829)
Nursing home services	-	-	37,556	35,434	37,556	35,434	2,122
Total expenses	8,106,542	7,352,937	329,812	332,090	8,436,354	7,685,027	751,327
Special item	(8,838)	-	-	-	(8,838)	-	(8,838)
Increase in net assets before transfers	379,926	289,562	89,272	94,199	469,198	383,761	85,437
Transfer from lottery and games	65,376	73,800	(65,376)	(73,800)	-	-	-
Increase in net assets	445,302	363,362	23,896	20,399	469,198	383,761	85,437
Net assets - Oct 1	2,114,026	1,750,664	394,443	374,044	2,508,469	2,124,708	383,761
Net assets - Sept 30	\$ 2,559,328	\$ 2,114,026	\$ 418,339	\$ 394,443	\$ 2,977,667	\$ 2,508,469	\$ 469,198

Please refer to Note 1.X – Reconciliation of Government-Wide and Fund Financial Statements, on page 73, for additional information on the differences between the two bases of accounting that the District uses in this Report.

Chart 1 shows various sources of revenues. This chart is a visual presentation of the numbers that were presented in Table 2, *Change in Net Assets* for the year ended September 30, 2007 on page 28.

Chart 1 – Revenues by Source – Governmental Activities

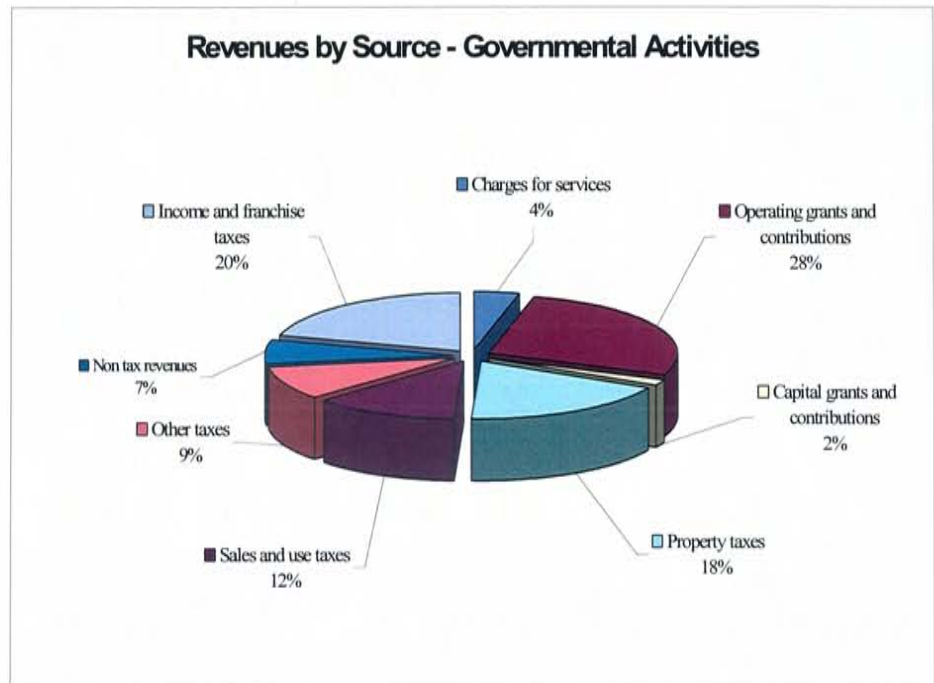
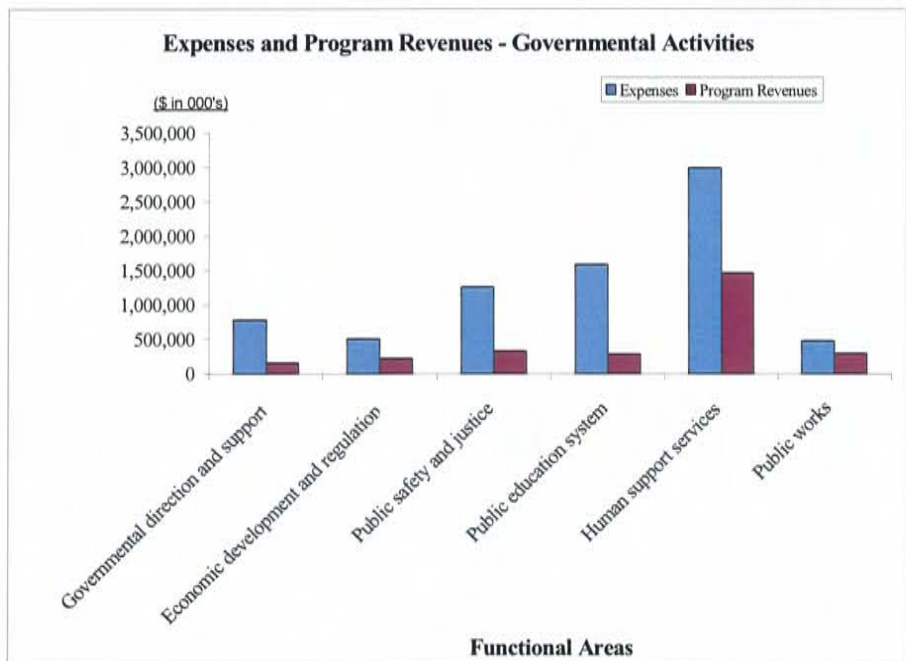


Chart 2 displays both expenses and program revenues of selected governmental activities for the fiscal year. The governmental activities that are shown are: governmental direction and support, economic development and regulation, public safety and justice, public education system, human support services and public works.

Chart 2 - Expenses and Program Revenues – Governmental Activities



Reporting on the District's Most Significant Funds

A fund is a fiscal and accounting entity with a self-balancing set of accounts that the District uses to keep track of specific sources of funding and spending for a particular purpose. In accordance with District law, bond covenants, and other legal stipulations, funds are established for specific purposes and to report on the activities related to the goods and services that the District provides to the general public. The District's funds are presented in three categories or groups: governmental, enterprise, and fiduciary.

The focus of the fund financial statements' presentation is on major funds, and not on fund types. Major funds, as required by GAAP, are presented individually with non-major governmental funds combined in a single column. Detailed information for individual non-major governmental funds can be found in 'Other Supplementary Information', Exhibits B-1, *Combining Balance Sheet* and B-2, *Combining Statement of Revenues, Expenditures and Changes in Fund Balances*, pages 126 and 127.

Governmental Funds

The District's governmental funds provide information on near-term inflows, outflows, and balances of spendable resources. This information is useful in assessing the District's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. The governmental fund financial statements relate to the governmental activities column in the government-wide statements. The focus is on a shorter-term basis and measures how money flows into and out of these funds and determines the balances left at year-end for future spending.

Most basic services are found in this fund category, which are reported as General, Federal and Private Resources, General Capital Improvements, Baseball Capital Project, and Non-major Governmental Funds. These funds are reported using the *modified accrual basis of accounting*, which measures cash and other financial assets that can be readily converted into cash. Please refer to Exhibit 2-a, *Balance Sheet – Governmental Funds* and Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds*, pages 48 and 49, for more detailed information about these funds.

- **Fund Balances:** The governmental funds reported a combined fund balance of \$2,789,580, an increase of \$299,958 over the previous year. The components of this combined fund balance are as follows:
 - General Fund - \$1,494,000, an increase of \$58,858 over the previous year.
 - Federal and private resources - \$134,249, a decrease of \$ (27,061) over the previous year.
 - General capital improvements - \$703,763, an increase of \$306,943 over the previous year.
 - Baseball capital project - \$113,042, a decrease of \$(215,539) over the previous year.
 - Nonmajor governmental funds - \$344,526, an increase of \$176,757 over the previous year.
- **Revenues:** The collection of taxes and other revenues increased in FY 2007 due to the continued strength of the Washington, D.C. economy. Revenues of the governmental funds increased by \$854,436. Property taxes, income and franchise taxes, and sales and use taxes continued to show steady increases. Commercial retail and office space growth continued, and commercial vacancy rates remained amongst the lowest in the nation.

On the residential side, longer commuting times, for non-resident employees, have made Washington, D.C. a more attractive place to live. The growth in the wages and salaries of residents contributed to the increase in individual income tax revenue. The increase in the sales and use tax was due to increased retail and hospitality sales, a result of increased individual income and the growth in the number of conventions and visitors.

The primary sources of the increases in General Fund revenues are:

- Property taxes increased by \$310,418.
- Income and franchise taxes increased by \$144,878.
- Other taxes increased by \$217,866.

The increase in real property tax revenue in FY 2007 reflects the strength of the D.C. real estate market two-years prior, since there is a two-year lag between the times when real property value is assessed and when the revenue from the increased assessment is realized. As the demand for residential and commercial real estate has soared in

the last several years, prices have climbed steeply and the result has been higher assessments and increased tax revenue, despite several rounds of tax relief to the residential sector.

The rise in individual income tax revenue, despite another round of tax cuts from the phased implementation of Tax Parity, reflects the strong growth in income of D.C.'s top earners. The largest source of growth was from the non-withholding portion of the income – the portion that is tied closely to stock market returns. This suggests that the strong growth in returns from the financial markets in the previous year was the main driver of the continued growth in the individual income tax.

The growth in miscellaneous revenues was the result of fluctuations in unclaimed property and end of year adjustments resulting from a change in estimates relating to expenditure accruals. Please see Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds*, page 49, for more detailed information.

Dedicated Revenues

Every year, some portion of various District revenue streams are dedicated to certain purposes. The dedicated portion of the tax revenues is transferred out of the local fund, and is thus not available for general budgeting. In FY 2007, the District transferred a total of \$456 million in tax revenues out of the local fund budget to fund the projects in Tables 3a and 3b.

Table 3a – Dedicated Local Tax Revenues (\$ in 000's)

Tax Revenue Source	Dedicated Purpose (Transfer to)									
	Gross Collection	TIF	Neighborhood Investment Fund	DDOT	Convention Center	Ballpark Fund	Highway Trust Fund	Nursing Facility Quality of Care Fund	School Modernization	Net Collection
Real Property	\$ 1,448,697	(5,096)								1,443,601
Personal Property	67,395		(10,000)							57,395
Public Space Rental	32,239			(32,239)						-
General Sales	959,968	(14,205)		(37,087)	(83,312)	(8,275)			(100,000)	717,089
Motor Fuel Tax	26,776						(26,776)			-
Public Utility	163,792					(10,503)				153,289
Toll										
Telecommunications	59,071					(2,285)				56,786
Healthcare Provider Tax	12,393							(12,393)		-
Baseball Gross Receipts Tax	24,888					(24,888)				-
TOTAL	\$ 2,795,219	(19,301)	(10,000)	(69,326)	(83,312)	(45,951)	(26,776)	(12,393)	(100,000)	2,428,160

Table 3b – Dedicated Local Tax Revenues-Housing related (\$ in 000's)

Housing Related Dedicated Tax				
Budgetary Dedicated Tax Transfers	Gross Collection	HPTF	Mayor's Housing Fund	Available for General Fund use
Deed Recordation	226,743	(34,734)	(18,075)	173,934
Deed Transfer	152,411	(23,998)	(12,071)	116,342

Source: Office of Tax and Revenue

- **Expenditures:** The District's expenditures increased in most of its program/functional areas in the total amount of \$692,917 over the previous year. The program/functional areas were led by an increase in governmental direction and support of \$40,354, human support services of \$23,184, the public education system of \$101,684, public safety and justice of \$107,884, economic development and regulation of \$96,417, and public works of \$145,742.

The District spent \$742,499 on general capital improvements which exceeded the general capital improvements revenues of \$199,420 by \$(543,079), resulting in the deficiency shown in the capital projects fund. The District investments in capital improvements are based on need rather than available current year revenues, before considering current year bond proceeds. This deficiency is subsequently financed through a total of \$850,022 of bond proceeds and other financing sources. The net change in the general capital improvements fund balance was an increase of \$306,943 .

The District is rapidly investing in infrastructure and other improvements to encourage residents and businesses to stay in the District and to attract new residents and businesses. Please see Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances*, page 49, for more detailed information.

Listed below are the eight major infrastructure projects undertaken in FY 2007, by costs incurred:

1)	South Capital Street Bridge over Anacostia River, Design & Build	\$20,746
2)	Ward 5 Resurface/Reconstruct/Upgrade, Design & Build	\$20,341
3)	Street Repair and Maintenance, Equipment & Tech. Improvement	\$13,396
4)	Streetlight Replacement Contract	\$ 8,208
5)	Preventative Maintenance and Emergency Repairs on Highways & Streets	\$ 7,053
6)	Traffic Signal Maintenance	\$ 6,150
7)	Pave/Restore NHS	\$ 5,754
8)	Rehabilitate South Capital Street Bridge (Fredrick Douglas Bridge)	\$ 5,142

It is the District's financial policy to issue general obligation bonds to support the expenditures associated with its Capital Improvements Program. In order to minimize the cost of carrying debt, the District has instituted the practice of issuing bonds based on actual expenditures, in some cases, as well as based on the annual amount budgeted. In practice, agencies are authorized to spend their annual appropriated capital budget in advance of financing. The General Fund advances the amount of the funding, and is repaid with the proceeds from the bonds when issued. This allows the District to determine when it will enter the market to issue bonds based upon cash flow needs, favorable market rates and the number of municipal debt financing and the types of credits that are available. This flexibility helps to minimize borrowing costs and maximizes the pool of potential investors for the District's debt issuances.

Proprietary Funds

Proprietary funds account for activities of District entities that charge customers fees for services provided, whether to outside customers or to other entities of the District. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. The District currently has two major Proprietary Funds: the D.C. Lottery & Charitable Games Board (Lottery), and the Unemployment Compensation Fund (Unemployment). There is one non-major proprietary fund, Nursing Home Services, which includes the operations of the Washington Center for Aging Services, the Washington Center for Aging Services Center Care, and the JB Johnson Nursing Center. See *Chart 3, Expenses and Program Revenues – Business-Type Activities* and *Chart 4, Revenues by Source – Business-Type Activities*, both on page 33, which give a visual comparative presentation of the revenues and expenses of the three funds.

The total assets for Lottery decreased by \$(7,884), or -11.3%, over the previous year due to scheduled disbursements to long-term prize winners. The total assets for Unemployment increased by \$23,837, or 6.1%, due to higher tax collections from employers. The net cash provided by (used in) operating activities for Lottery, Unemployment and non-major proprietary funds (Nursing Services) were \$61,978, \$6,341, and \$(2,050) respectively. See Exhibit 3-a, *Statement of Net Assets – Proprietary Funds*, Exhibit 3-b, *Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds*, and Exhibit 3-c, *Statement of Cash Flows – Proprietary Funds*, on pages 52, 53 and 54 respectively for more detailed information.

Proprietary entities provide goods and services to the general public and use the *full accrual accounting* method for reporting purposes.

Charts 3 and 4 are graphic comparisons based on financial information in Table 2 - Change in Net Assets for the year ended September 30, 2007 on page 28.

Chart 3 – Expenses and Program Revenues – Business-type Activities

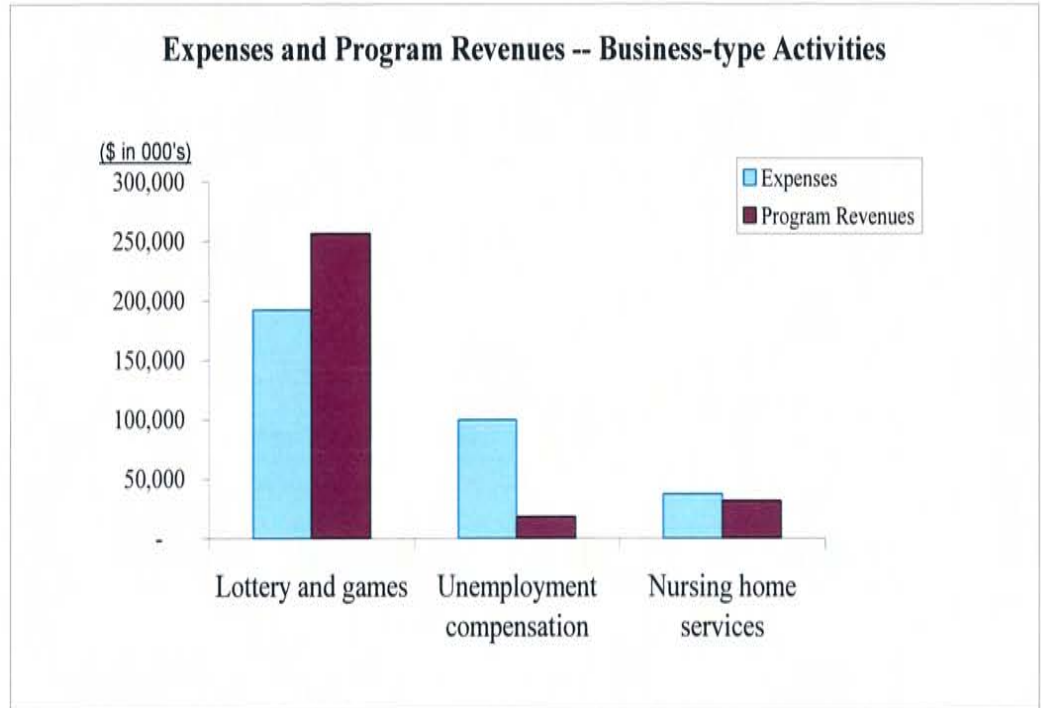
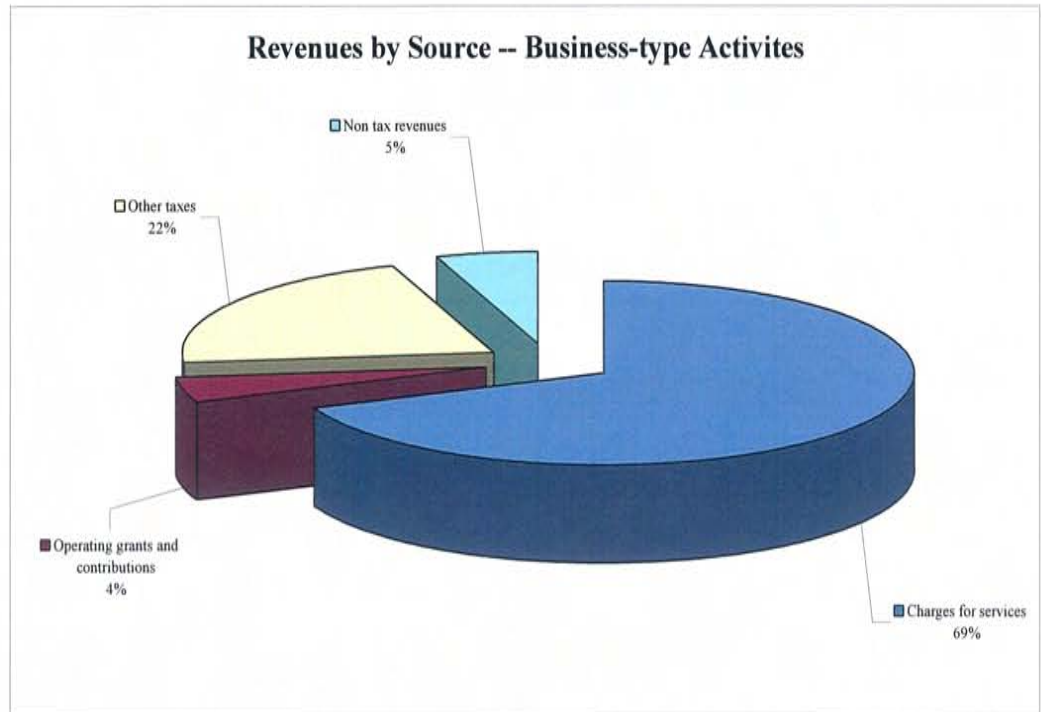


Chart 4 – Revenues by Source – Business-type Activities



Fiduciary Funds

The *Trust and Agency Funds* are used to account for assets held by the District as trustee for individuals, private organizations, or other governments. The District is the *trustee or fiduciary* for its employees' pension plans and other post employment benefits. All fiduciary activities are reported in Exhibit 4-a, *Statement of Fiduciary Net Assets* and Exhibit 4-b, *Statement of Changes in Fiduciary Fund Net Assets* on pages 55 and 56, respectively. Please also refer to Exhibit C-1, *Pension Trust Funds – Combining Statement of Fiduciary Net Assets*, Exhibit C-2, *Pension Trust Funds – Combining Statement of Changes in Fiduciary Net Assets* on pages 130 and 131 respectively, for more details. These activities are excluded from the District's financial statements because these resources are restricted and are not available to support the District's operations.

Private-purpose trust funds are used to report any trust arrangement not reported in pension funds or investment trust funds "under which principal and income benefit individuals, private organizations, or other governments." The District offers a tax-advantaged 529 College Savings Investment Plan (named after Section 529 of the Internal Revenue Code). The Plan is designed to help families save for the higher education expenses of designated beneficiaries which is available to D.C. residents and non-residents. This plan is reported in the Private-purpose trust fund, and was established during FY 2003. Please see Note 1-E, *Fiduciary Funds – Private Purpose Trust Fund* on page 63.

The net assets of the pension trust fund increased by \$782,023. Net investment income is the primary source of the increases as both entities continue to benefit from the improved U.S. equity and non-U.S. equity markets, and from prudent investment management.

The Component Units

The District currently has eight (8) discretely presented component units: (1) Anacostia Waterfront Corporation; (2) District of Columbia Economic Development Finance Corporation (EDFC); (3) Housing Finance Agency; (4) National Capital Revitalization Corporation (NCRC); (5) DC Sports and Entertainment Commission; (6) University of the District of Columbia; (7) Washington Convention Center Authority; and (8) DC Water and Sewer Authority. The Council enacted the Reorganization Clarification Act of 2007 to dissolve the Boards of NCRC and EDFC. The Act vests in the Mayor the right to succeed to the powers, duties, and responsibilities of the Board of Directors of both the NCRC and EDFC. The exercise of the power to dissolve the NCRC and EDFC constituted a prima-facie evidence of imposition of will by the District. Consequently, these two entities are regarded as component units of the District in fiscal year 2007. NCRC and EDFC had previously been treated as related organizations, because the District was not financially accountable for their operations at that time. Component units are legally separate organizations for which the District is financially accountable. Accountability exists because the Mayor, with the consent of the Council, appoints the governing bodies of all of the component units. In addition, the District has an obligation to provide financial support to the Convention Center, and the University of the District of Columbia. Certain tax revenues are dedicated to each of these organizations. The financial data of the component units are reported separately from the financial data of the primary government.

The District also has one blended component Unit: Tobacco Settlement Financing Corporation (Tobacco Corporation). The Tobacco Corporation is a blended component unit because it provides services exclusively to the District.

Each of the component units except NCRC and EDFC, prepares its own independently audited financial statements, which are accompanied by their respective MD&A. Please see Exhibit 5a, *Discretely Presented Component Units - Combining Statement of Net Assets*, page 57, and Exhibit 5b, *Discretely Presented Component Units - Combining Statement of Activities*, page 58, for more detailed financial information on the component units.

Short-Term Debt

The District issues short-term debt primarily to finance seasonal cash flow needs. This need occurs due to the timing variance between the receipt of taxes, grants and other revenues and the outflow of funds for governmental operations and required disbursements. The District issued \$300,000 in Tax Revenue Anticipation Notes (TRANs) on December 21, 2006, at an interest rate of 4.25%, which has been repaid. By law, the District must repay any short-term debt in its entirety by September 30 of the fiscal year in which the debt was incurred. The FY 2007 TRANs were repaid on September 28, 2007.

Long-Term Debt and Bond Ratings

On June 7, 2007, the District issued its Series 2007A General Obligation Bonds in the principal amount of \$576,475. The proceeds of these bonds will be used to finance capital project expenditures and to pay the costs and expenses of issuing and delivering the bonds. Also, on June 7, 2007, the District issued its 2007B General Obligation Refunding Bonds in the principal amount of \$251,155. The proceeds of these bonds are being used to redeem, or defease, a portion of the District's outstanding general obligation bonds at a savings to the District and to pay the costs and expenses of issuing and delivering the bonds. The 2007A and 2007B bonds, together with other outstanding general obligation bonds and bonds to be issued in the future, are general obligations of the District, secured by the District's full faith and credit, and are further secured by a security interest and lien on the funds derived from a Special Property Tax, and are issued under Section 461 of the Home Rule Act. The 2007A bonds were issued as fixed-rate bonds with a weighted average interest rate yield of 4.69%. The 2007B bonds were issued as fixed-rate bonds with a weighted average interest rate yield of 4.47%. Interest payments for the 2007A and 2007B bonds began in December 2007, and will be made each year on June 1st and December 1st until paid off. Principal payments will begin in 2029 for the 2007A bonds and 2016 for the 2007B bonds, and will be made each year on June 1st until paid off. The 2007A bonds and 2007B bonds will mature and be fully paid off on June 1, 2037 and June 1, 2030, respectively.

In May 2007, Moody's Investors Service upgraded the District's general obligation bond rating to "A1" from "A2 (Positive Outlook)". Standard & Poor's maintained the District's general obligation bond rating of "A+" where it has been since it was upgraded from "A" in November 2005. In May 2007, Fitch Ratings upgraded the District's bond rating from "A (Positive Outlook)" to "A+." Each time the District issues new debt, the current debt rating is reviewed for the new issuance. At that time, the bond rating agencies assess the District's financial condition, and underlying credit worthiness, and change their rating as warranted.

The significantly improved bond ratings allow the District to either refinance outstanding debt, or issue new debt, at more favorable rates. In the past, the District's financial and operational difficulties required it to pay substantially higher interest rates on its debt. The District's financial advisors estimate that the effect of the upgrades on the District's recent general obligation bond sale was a savings of approximately 5 basis points, or \$200,000 per year. A basis point is one-percent of a percentage point of interest, or 0.01%. Lower interest rates translate into reduced debt service payments, resulting in a greater percentage of the District's budget being available for the services and operations needed for its citizens.

At September 30, 2007 the District had a total of \$5,515,708 in general obligation bonds, TIF Bonds, Qualified Zone Academy Bonds (QZAB), and Tobacco Bonds outstanding. Please refer to Table 4, *Outstanding Bonds at September 30, 2007*. This is an increase of \$335,238 over last year. General obligation bonds represent 75.1% of the District's outstanding long-term debt. TIF bonds and QZAB represent 2.0% and Tobacco bonds outstanding represent 13.4% of its outstanding long-term debt. In FY 2006, the District issued \$534,800 in Ballpark Bonds to finance the new baseball stadium, of which \$528,490 remains outstanding, or 9.6% of the District's outstanding long-term debt. The District's borrowing has been increasing over the past few years because of the continuing need and demand for improvements in infrastructure, such as roads, streets, and bridges. (Please see *Note 8. Long-Term Liabilities*, pages 89-90 for a more detailed discussion).

The general obligation debt per capita (D.C. resident) as of September 30, 2007 was \$7,038. This is an increase of \$592, or 9.2% over last year. The increase is due to the District's issuance of additional general obligation debt. The debt per capita figure that was given in last year's CAFR for FY 2006 may not correspond to the figure given in this year's CAFR because of adjustments in census estimates. Please refer to Exhibit S-3A, *Ratios of General Obligation Bonds Outstanding – Last Ten Fiscal Years* on page 160.

Table 4 – Outstanding Bonds at September 30, 2007

Long-Term Debt			
(\$ in 000's)			
	2007	2006	Variance
General Obligation Bonds	\$ 4,140,133	\$ 3,773,863	\$ 366,270
Ballpark Bonds	528,490	534,800	(6,310)
TIF Bonds *	105,229	124,302	(19,073)
Qualified Zone Academy Bonds	4,787	5,221	(434)
Tobacco Bonds	737,069	742,284	(5,215)
Total	\$ 5,515,708	\$ 5,180,470	\$ 335,238

* FY 2006 included TIF notes and bonds.

Capital Assets

Net capital assets of the governmental activities totaled \$6,139,898, while the net capital assets in business-type activities totaled \$17,211, for a total of \$6,157,109 net capital assets at September 30, 2007. These capital assets include, but are not limited to, land, buildings, police and fire equipment, office equipment, park facilities, roads and bridges. The governmental activities depreciation charges for the current fiscal year totaled \$260,821 compared to last year's \$225,809. The general capital improvements fund is used to account for the purchase or construction of capital assets financed by transfers, capital grants, and or debt. Please see Table 5, *Net Capital Assets*, below for more details.

Total capital assets increased by \$592,863 or 10.7%, over last year. This increase was made up of an increase in governmental activities capital assets of \$593,157 or 10.7% and an decrease in capital assets from business-type activities of \$(294), or -1.7%. Total capital assets are increasing because the District is investing more resources in new and existing rehabilitated infrastructure, such as roads, streets, and bridges. The cost of these assets is being funded primarily by the issuance of debt, and the use of General Fund fund balance. Please see Note 5 - *Capital Assets* for a more complete discussion of the District's capital assets, on pages 83-87.

Table 5 – Net Capital Assets as of September 30, 2007

Asset Category	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006 Restated	2007	2006 Restated
	Land	\$ 219,920	\$ 219,938	\$ 1,264	\$ 1,264	\$ 221,184
Buildings	1,679,673	1,701,162	13,402	14,464	1,693,075	1,715,626
Infrastructure	1,884,395	1,792,926	-	-	1,884,395	1,792,926
Equipment	503,148	512,232	2,545	1,777	505,693	514,009
Construction in progress	1,852,762	1,320,483	-	-	1,852,762	1,320,483
Total net capital assets	\$ 6,139,898	\$ 5,546,741	\$ 17,211	\$ 17,505	\$ 6,157,109	\$ 5,564,246

REPORTING THE DISTRICT'S BUDGET

The District's budget is subject to revision and/or veto by the United States Congress and the President of the United States. As the budget moves through the federal budgetary process, there may be changes in both the amounts and the purposes. In addition, when the District's CFO prepares revised revenue estimates, the budget submission must be adjusted to conform to those revisions. During the Congressional review of the FY 2007 budget, the CFO's revised estimates caused the District to revise its budget submission, before the budget was finally approved. Both federal and District laws require that the District present a balanced budget.

General Fund Budget

The original formulation of the General Fund budget estimated total revenues and other sources at \$5,613,643 and total expenditures and other uses at \$5,611,811. The revised General Fund budget, resulted in estimated total revenues and other sources of \$5,735,277 and total expenditures and other uses of \$5,734,781, resulting in a projected budgetary surplus of \$496. See Table 6, *Fiscal Year 2007 – General Fund Budgetary Highlights*.

Table 6 - Fiscal Year 2007 General Fund Budgetary Highlights

	Budget		Actual	Variance with Revised Budget
	Original	Revised		
Revenues and Other Sources:				
Property taxes	\$ 1,366,247	\$ 1,421,903	\$ 1,500,996	\$ 79,093
Other taxes	3,109,495	3,083,225	3,286,775	203,550
Charges for services	333,857	337,561	423,875	86,314
Other sources (O type)	525,614	446,201	366,511	(79,690)
All other sources	278,430	446,387	208,994	(237,393)
Total revenues and other sources	5,613,643	5,735,277	5,787,151	51,874
Expenditures and Other Uses:				
Governmental direction and support	433,758	432,526	366,258	66,268
Economic development and regulation	409,394	437,945	380,623	57,322
Public safety and justice	943,293	977,060	961,429	15,631
Public education system	1,223,971	1,174,460	1,155,629	18,831
AY08 public education expenditures	-	85,047	85,047	-
Human support services	1,423,138	1,533,234	1,512,702	20,532
Public works	405,318	447,792	429,971	17,821
Other	772,939	646,717	614,638	32,079
Total expenditures and other uses	5,611,811	5,734,781	5,506,297	228,484
Excess -- budgetary basis	\$ 1,832	\$ 496	\$ 280,854	\$ 280,358

General Fund Budgetary Highlights – Original to Revised Budget

The adjustments necessary to bring the expenditure budget into agreement with the revised revenue budget account for the differences between the proposed General Fund budget and the final amended budget. Total estimated revenues were increased by \$121,634 and total estimated expenditures were increased by \$122,970. The projected General Fund budgetary basis surplus was decreased from \$1,832 to \$496, as a result of the revisions. The major changes in the budget are summarized as follows:

Revenues

- Property taxes increased by \$55,656.

- Other sources (O Type) decreased by \$(79,413).
- All other sources increased by \$167,957.

Expenditures

- The advance of Appropriation Year 2008 budget in the amount of \$85,047 for public education expenditures, to ready the public schools for the new school year which began prior to the District's fiscal year.
- Human support services expenditures increased by \$110,096.
- Other, which represents various nonfunctional expenditures on a budgetary basis decreased by \$(126,222).

FY 2007 Original Budget to Revised Budget Revenue Variances

The \$55.7 million (4%) increase in the revenue estimate for **real property tax** between the original and revised budget reflects adjustments that were made to the real property tax estimate based on first billing receipts that became available after the original estimate was made. Although assessed values are known at the time the original estimate is made, actual real property tax receipts reflect adjustments to the assessed values from successful appeals (which are not known at the time that the original estimate is made). Data from first billing receipts are therefore used to make a more accurate estimate.

The revenue estimate for the **individual income tax** was adjusted downward by \$26.2 million (2%) as data on revenue collections through March 2007 showed slower than expected growth in withholding collections.

The revenue estimate for the **general sales and use tax** was revised downwards by \$37.2 million (5%) after data on cash collections and the final tally of revenues for FY 2006 showed sharp slowing in sales tax growth for FY 2006. There were also signs of weakness in the hospitality sector. In the three (3) month period ending August 2006, the hotel occupancy rate was down 5.1 percent from a year ago.

The revenue estimates for the **business income taxes** (corporation franchise and unincorporated business taxes) were revised upwards by a total of \$68.8 million (19%), a \$33.6 million increase for the corporation franchise tax and a \$35.2 million increase for the corporate income tax. There were two reasons for the upward revision in the business income taxes: (1) The final tally of revenue for FY 2006 showed that business income tax cash receipts grew 14 percent over the previous year compared to a forecast of 11 percent and (2) data on revenue collections through March 2007 showed faster than expected growth in the business taxes.

The revenue estimates for **deed recordation and transfer taxes** were lowered by a total of \$106.7 million (27%) as data and forecasts throughout the year pointed to a cooling DC real estate market. By the time the revised revenue estimate was completed in May 2007, data from the previous year showed that:

- In the third quarter of 2006, housing sales (including both single family and condos) were down 15.2 percent from a year ago and prices were up just 0.4 percent. Single family sales were down more than condo sales, but single family prices were up 5.9 percent while condo prices were down 2.8 percent
- D.C. office vacancy rates remained low at 6.2 percent, the lowest in the D.C. metropolitan area and among the lowest nationally, but the value of office sales had declined 25 percent in FY 2006 compared to FY 2005.

The revenue estimate for the **estate tax** was increased by \$35.5 million (177%) between the original and revised estimate as data on cash collections at the time of the revised estimate showed that revenue collections from this source was much stronger than anticipated. Revenue from estate tax is notoriously volatile because revenue flows depend on the number of deaths of persons with taxable estate in the District as well as the value of estates, which in turn is tied to the real estate market and the volatile financial market.

The revenue estimate for the **economic interests tax** was increased by \$44.1 million (551%) between the original and revised estimate to be consistent with the much stronger than anticipated collections from this source data after reviewing cash collections reports. Like the estate tax, receipts from the economic interests tax are very volatile because it depends on volume and value of transactions in the real estate investment trust markets (REITs), which is volatile.

FY 2007 Original Budget to Revised Budget Expenditure Variances

The \$110,096 increase for Human Support Services (HSS) was caused primarily by five items: (1) the Department of Human Services (DHS) was increased by \$34,822; (2) the Department of Health (DOH) was increased by \$27,257; (3) the Medicaid Reserve was increased by \$26,927; (4) the Department of Mental Health (DMH) was increased by \$14,718, and (5) the D.C. Energy Office was decreased by \$(12,848). The largest increase for DHS was the result of a \$29,530 increase from the FY 2006 Operating Cash Reserve. The increase for DOH was primarily the result of a \$10,987 from FY 2006 Operating Cash Reserve and \$11,139 from additional certified revenues. The DMH increase was entirely due to two items: (1) an increase of \$10,155 from additional certified revenues, and (2) \$4,563 allocated from Workforce Investments for salary increases. The decrease for the Energy Office was as a result of transferring the entire office to the new Department of the Environment.

The \$85,047 AY 2007 Advance for Public Education represents the expenditure of the appropriations for AY 2008 in FY 2007. The FY 2007 D.C. Appropriations Act requires that the advance appropriations be provided on July 1, 2007, based on 10% and 25% of the FY 2007 Proposed Budgets for the D.C. Public Schools and the D.C. Public Charter Schools, respectively. When Congress approves the District's budget for the current fiscal year, it does not know the proposed funding level for the next fiscal year. As such, the advance appropriations are not included in the District's Original Budget. The advance appropriations are not known until July 1, and are then made a part of the District's Revised Budget.

The \$42,474 increase for Public Works was primarily the result of: (1) an increase of \$9,173 for the Department of Public Works (DPW), (2) an increase of \$13,578 for the Department of Transportation (DOT) and (3) an increase of \$19,583 for the Department of the Environment (DOE). The DPW increase was primarily a result of an increase of \$4,000 from a Workforce Investment allocation for pay increases and \$5,000 in a reprogramming from the Office of the Chief Financial Officer. The DOE increase was mainly the result of the transfer of the entire \$12,848 budget of the D.C. Energy Office from the Department of Human Service to DOE and a \$5,050 transfer from Storm Water.

The \$33,767 increase for Public Safety and Justice was made up principally of: (1) the \$16,443 increase for the Metropolitan Police Department (MPD); (2) a \$10,472 increase for the Department of Corrections (DOC); and (3) a \$4,969 increase in Fire and Emergency Services. The MPD increase was the result of several changes, mainly: (1) a \$10,500 increase for tax triggered expenditures; (2) an allocation of \$6,675 from Non-Departmental for the hiring of additional police employees; (3) a \$998 allocation from Workforce Investments for pay increases; (4) a \$5,971 increase in the Mayor's crime initiative program, and (5) \$(8,001) in decreases in various reprogrammings to other agencies. The DOC increase was due to reprogrammings of \$2,000 from the Repayment of Loans and Interest, less \$500 to the Department of Health for fixed costs, and various Non-Departmental allocations totaling \$8,972.

The \$28,551 increase for Economic Development and Regulation was primarily the result of: (1) a \$12,098 increase for the Office of the Deputy Mayor for Business Services and Economic Development (BSED); (2) a \$8,054 increase for the Department of Housing and Community Development (DHCD); (3) a \$14,887 increase for the Department of Employment Services (DOES), and (4) a \$15,007 decrease for the Housing Production Trust Fund Subsidy (HPTFS). The BSED increase was due mainly to a \$6,480 increase from Master Lease and \$3,500 from PAYGO. The DHCD increase was due mainly from the reprogramming for the Home Loans program from the HPTFS. The reduction in the HPTFS is due primarily to a reprogramming of \$8,000 of the Home Loans program to DHCD, and a \$7,007 reduction in appropriation to the level of dedicated deed recordation and deed transfer taxes to be transferred to the Housing Production Trust Fund Special Revenue Fund.

The \$(49,511) decrease for Public Education was composed primarily of two items: 1) an increase of \$8,299 for the D.C. Public Schools and 2) a decrease of \$(66,421) for Public Charter Schools. Of the \$(66,421) decrease for Public Charter Schools, the net decrease reflects a reprogramming of \$(16,900) and the FY 07 budget advanced and expended in FY 2006 \$(58,400). Partly offsetting these decreases is an allocation from the Public Charter School Educational Investment fund of \$3,110. The advance appropriations for the AY 2008 Public Charter Schools were not included in the June budget submission to the U.S. Congress. The proposed budget for FY 2008, upon which the advance appropriations is based, was not developed at the time of the current fiscal budget submission to Congress.

The \$(126,222) decrease for "Other" was made up of five major items; (1) a decrease of \$(49,500) for the Cash Reserve; (2) a decrease of \$(30,627) for Workforce Investments; (3) a decrease for Non-Department of \$(44,996), and (4) a decrease of \$(21,927) for Equipment Lease Operating. These four items total \$(147,050), which was offset by net \$20,828 increase in other items. The change in the Cash Reserve was a result of the increase in allocation by the D.C. Council to various agencies to fund spending pressures and/or policy initiatives. The decrease in the budget for workforce investments reflects \$(30,627) in allocations to various agencies to cover pay raises.

FY 2007 Revised Budget to Actual Revenue Variances

The **real property tax**, with a positive variance of \$79 million, has the second largest variance, in absolute terms, of any revenue source. This is partly because it is the largest source of revenue so that even with a percentage variance less than 10%, the absolute magnitude of the variance is large. Real property assessments are generally known at the time of the estimate with two exceptions: 1) reductions to assessments from appeals to the Board of Real Property Assessments and Appeals; and 2) supplemental assessments made to capture higher assessments from new construction and renovations. For FY 2007, reductions in assessments from appeals was higher than estimated, but this was more than offset by higher than estimated supplemental assessments, resulting in the observed positive variance.

The **individual income tax**, with a positive variance of \$103.5 million, has the single largest variance, in absolute terms, of any revenue source. Like the real property tax, this is partly because it is the second largest source of revenue so that even with a percentage variance of less than 10%, the absolute magnitude of the variance is large. In May, when data was not yet available, the revised estimate was made on the non-withholding components of the tax (especially final payments and refunds) which can swing the individual income tax into the red in a bad year. At that time, the monthly collections data showed slowing growth in the withholding component. Preferring to err on the side of caution, we made a fairly conservative estimate. The final collections data showed that even though growth in the withholding component of the individual income tax was flat, the net of the non-withholding components (declarations plus final payments, plus fiduciary and less refunds) grew significantly more than forecast, resulting in the large observed variance.

The positive variances of \$49.6 million (28%) for the **deed recordation tax** and \$38.3 million (34%) for the **deed transfer tax** are due to better than expected performance of the District's real estate market despite a nationwide slowdown in housing. Revenue from deed recordation and transfer tax depends crucially on the value of transactions in the real estate market. This means that, unlike the real property tax where the revenue depends only on the price changes through the assessment process, the deed taxes revenue depends both on the price and the value of transactions. At the time the revised estimate was completed, total value of real estate transactions for the first quarter of calendar year 2007 was down almost 9% from the same quarter of the previous year. Given the considerable state of uncertainty with respect to the D.C. real estate market at the time, prudence required that our estimate of deed taxes collection be conservative. The DC real estate market held up better than expected and deed taxes collection was stronger than expected.

The **economic interests tax** is paid when owners of real estate assets sell their ownership interests in assets rather than the property itself. Revenue from the economic interest tax fluctuates from year to year because most of the revenue from this tax is generated from activity in the real estate investment trusts (REITs) market which, like financial markets, are inherently difficult to predict. In FY 2007, there was a one time large sale of interests in DC real estate holdings, generating a huge payment of economic interests. We believe that this one time sale explains most, if not all, of the \$12.7 million (24%) variance between the actual and revised estimate.

Most of the positive variance of \$88.1 million for the **miscellaneous** category is attributed to higher than expected revenues from **Interest Income and Unclaimed Property**. About \$40.7 million, or nearly half, of the total variance in this category is attributable to higher than expected revenue from Interest Income. Two major bond issuances were responsible for the higher than expected revenue from interest income: (1) issuances associated with tobacco bonds and (2) issuances related to the Certificate of Participation (COP) (St. E's) program. Although it is generally known at the time that the revenue estimate is made that these issuances will occur sometime during a given calendar year, it is difficult to determine beforehand the exact timing of the issuance—whether it will fall within one fiscal year or the other (two fiscal years overlap with a given calendar year). So prudent revenue estimating requires that we do not factor these into the estimate. The bulk of the remaining positive variance is due to higher than expected revenue from Unclaimed Property. The higher Unclaimed Property revenue is due primarily to an unexpected appreciation of stock and new stock received from demutualization of insurance companies that occurred in March of 2007. There was also an unexpected influx of unclaimed funds from District of Columbia agencies.

FY 2007 Revised Budget to Actual Expenditure Variances

Total expenditures and uses were under budget by \$228,484 for FY 2007. The two largest expenditure variances for FY 2007 were for governmental direction and support of \$66,268 and \$57,322 for economic development and regulation. The Office of the Mayor accounted for \$46,380 of the \$66,268 decrease for Governmental Direction and Support.

Economic Development and Regulation expended \$57,322 less than budgeted. Within Economic Development and Regulation, the majority of the variance was caused by: (1) the \$26,242 variance within Business Services and Economic Development (BSED), (2) a \$13,205 variance within the Department of Housing (DHCD), and (3) the \$8,955 variance within the Department of Employment Services (DOES). The majority of the DHCD variance of \$10,724 was caused by the revenue estimates for the Housing Strategy Task Force Fund that was reduced mid-year. This variance represents budget authority that was above actual collections that the agency could not use. The DHCD variance is largely attributable to the agency not using budget authority in the Home Purchase Assistance Program (HPAP) Repayment Account. This was also done to preserve the HPAP Repayment fund balance for use in 2008 and beyond.

The DOES variance was primarily the result of a supplemental budget increase of \$10,597 to implement the Mayor's Summer Youth Program enhancement in addition to a few minor budget decreases. This new initiative prolonged the Summer Youth program from the original six-weeks that was originally budgeted to 10-weeks. It also required the agency to provide jobs for all applicants, as opposed to the 11,000 participants that were budgeted.

FY 2007 to FY 2006 Actual Revenue Variances

The \$291.5 million (25%) FY 2007 increase in **real property tax** over the previous year reflects an increase in real property prices over the last several years. 2005 was the peak year for property price appreciation. Property tax assessments lag behind the increases in real property values, and when real property values are becoming somewhat stagnant, property taxes will continue to increase, unless there is a significant reduction in real property values.

Although gross **sales and use tax** revenue for FY 2007 actually grew over 9%, the revenue net of transfers is down \$58.3 million (8%) over the previous year primarily because of the first year implementation of School Modernization.

The relatively strong growth of \$80.2 million (7%) in the FY 2007 **individual income tax** revenue over the previous year was due to the strong performance of the non-withholding part of the income tax (estimated payments, final payments, refunds); returns from the non-withholding portion is closely related to the financial market returns of the previous year and the financial markets did exceptionally well in 2006. The withholding portion of the tax was actually flat.

The relatively strong growth of \$40.2 million (19%) in the FY 2007 **corporate franchise tax** revenue over the previous year, although a slowdown from the growth of the past few years, is consistent with the strong growth in corporate profits that was seen over the last several years.

The FY 2007 revenue for the **unincorporated business (UB) tax** grew \$24.4 million (17%) over the previous year. The UB tax is collected primarily from real estate businesses and to a large extent reflects the fortunes of those businesses. As the DC real estate market boomed so did collections from this revenue source. As the real estate market slows, so does the revenue from the UB tax. Still, even with the slowing in the real estate market, FY 2007 revenue from the UB tax managed to grow at a double-digit growth rate.

The variance analysis showing a \$57.7 million (34%) increase in FY 2007 revenue over the previous year for the **deed recordation tax** and a \$38.9 million (34%) increase for the **deed transfer tax** is misleading. This is because the analysis compares FY 2007 figures, which is gross of transfer to the Housing Production Trust Fund (HPTF) to FY 2006 figures, which is net of the HPTF. When the HPTF transfers are added to the FY 2006 figures, the FY 2007 increase over the previous year for the deed recordation tax is \$28.5 million and \$19.1 million for the deed transfer tax. The increase is due primarily to an increase in the tax rate from 1.1% to 1.45% in FY 2007. Adjusting the FY 2007 figures for the rate increase shows both deed taxes falling by 13%, consistent with the slowdown in the real estate markets.

The FY 2007 \$24.1 million (80%) increase in the **inheritance and estate tax** revenue over the previous year is due mainly to an increase in value of estates tied to the financial and real estate markets.

The FY 2007 revenue from the **economic interests tax** grew \$34.5 million (114%) over the previous year because of unusually high activity in the market for real estate investment trusts (REITs) and, in particular, because of a one time large sale of interests in DC real estate holdings, generating a huge payment of economic interests.

FY 2007 to FY 2006 Actual Expenditure Variances

The net increase of \$128,861 in Economic Development and Regulation expenditures was caused primarily by: (1) a \$105,411 increase in the Housing Production Trust Fund Subsidy; (2) a \$35,879 increase in Business Services and Economic Development; (3) an increase of \$21,463 in the Department of Employment Services, and (4) a decrease of \$(45,842) in the Department of Housing and Community Development.

Human Support Services expenditures increased by \$123,127. This increase was caused primarily by: (1) a \$60,328 increase in the Department of Health; (2) a \$26,927 increase in Medicaid Reserve; (3) a \$15,352 increase in Child and Family Services, and (4) a \$13,628 increase in the Department of Human Services. The Department of Health variances were caused primarily by two items: (1) a \$28,900 increase in the District's Disproportionate Share payment, coupled with increased utilization of services, and (2) a \$25,500 increase as a result of increased enrollment in the D.C. Healthcare Alliance Program.

The increase of \$69,973 in expenditures for the Public Education System was caused primarily by: (1) a \$35,999 increase for Public Charter Schools; (2) a \$13,970 increase in the AY08 Public Charter School Advance Appropriation and (3) a \$7,848 increase for the D.C. Public Library. The Public Charter Schools variance was caused by an increase in actual student population from 17,343 in FY 2006 to 19,522 students in FY 2007, or 2,179 additional students. Per pupil funding for both residential and non-residential students was increased. These two factors accounted for the entire variance.

The Public Safety & Justice variance of \$66,681 was caused primarily by: (1) a \$22,600 variance for the Police and Firefighter's Retirement System; (2) a \$15,547 variance for Fire and Emergency Services; (3) a \$12,543 variance for the Metropolitan Police Department, and (4) a \$11,924 variance for the Department of Corrections.

The Public Works expenditure increase of \$66,173 was caused primarily by: (1) a \$26,942 increase for the Department of Environment; (2) a \$15,165 increase for the Department of Transportation; (3) a \$13,026 increase for the Department of Public Works, and (4) a \$10,869 increase for Mass transit Subsidies.

Expenditures for Government Direction and Support increased by \$32,711. This net increase was caused primarily by: (1) a \$13,958 increase for the Office of the Chief Financial Officer; (2) a \$13,653 increase for the Office of the Attorney General; (3) an increase of \$10,154 for the Department of Property Management, and (4) a decrease of \$(8,375) for the Office of the Chief Technology Officer.

The Finance and Other Uses decrease of \$(245,083) was caused primarily by: (1) a decrease of \$(133,300) for the District Retiree Health Contribution, and (2) a decrease of \$(146,162) for PAY-Go Capital. In FY 2006, the District funded Other Post Employment Benefits, in the amount of \$138,000. This was done to make sure that sufficient funds were placed in a trust account while the District had a large General Fund fund balance. These post-employment benefits are earned by District employees while they are employed and paid out during retirement. A new accounting pronouncement requires all state and local governments to fund these benefit liabilities as they are earned, instead of on a "pay as you go" basis. This change was made to more closely reflect the costs of employees' benefits in the year in which they are earned, giving a more accurate representation of the fiscal and financial health of municipal governments. The District is required to make an annual contribution for OPEB that equals the liability that is attributable to that year. The FY 2007 OPEB contribution was only \$4,700.

SUBSEQUENT EVENTS

Short-Term Debt

The District issues short-term debt to finance seasonal cash flow needs. This need occurs due to the timing variance between receipts of taxes, grants and other revenues and the outflow of funds for governmental operations and other required disbursements. On December 21, 2007, the District issued fixed-rate Tax Revenue Anticipation Notes in the aggregate amount of \$300,000. These Notes were issued at an interest rate of 4.00% and priced to yield 3.13%, and are to be paid off

on September 28, 2008. By law, the District must repay any short-term debt in its entirety by September 30 of the fiscal year of issuance.

Long-Term Debt

On December 19, 2007, the District issued its Series 2007C General Obligation Bonds in the principal amount of \$333,840. The proceeds of these bonds will be used to finance capital project expenditures and to pay the costs and expenses of issuing and delivering the bonds. The 2007C bonds, together with other outstanding general obligation bonds and bonds to be issued in the future, are general obligations of the District, secured by the District's full faith and credit. These bonds are further secured by a security interest and lien on the funds derived from a Special Property Tax and are issued under Section 461 of the Home Rule Act. The 2007C bonds were issued as fixed-rate bonds with a weighted average interest rate yield of 4.38%. The maturity of the 2007C bonds is June 1, 2033.

Special Item – Property Tax Refund Fraud

On November 7, 2007, federal authorities announced the arrest of two Office of Tax and Revenue (OTR) employees in connection with an alleged misappropriation of District funds by issuing fraudulent real property tax refund checks. The investigation into the size, scope and duration of the OTR fraud is continuing, and the District is fully cooperating with federal authorities. Although only two employees are currently believed to have actively participated in the fraud, to date fifteen OTR employees have resigned or been terminated. During FY 2007, the approximate amount alleged to have been stolen amounted to \$8.8 million. That amount has been reflected in the District's financial statements as a special item. An entry was made for this amount, to increase real property tax revenue and to create an offsetting account, Real Property Tax Loss. There will be no impact on cash and General Fund fund balance, as the amounts involved have already been reflected in those prior year financial statements. Any assets that are recovered from the participants of the OTR fraud will be reflected in the District's financial statements as Real Property Tax Loss Recovery Receivable. It is impossible to estimate that amount until a detailed inventory of seized assets becomes available, and its liquidated value is determined.

CONTACTING THE DISTRICT'S OFFICE OF THE CHIEF FINANCIAL OFFICER

This CAFR is designed to provide the District's citizens, taxpayers, customers, vendors, investors, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have any questions regarding this report, have suggestions for improvement, or need additional financial information, please contact:

The Office of the Chief Financial Officer
The John A. Wilson Building
1350 Pennsylvania Avenue, N.W., Suite 209
Washington, D.C. 20004
(202) 727-2476
www.dccfo.com