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

Natwar M. Gandhi
Chief Financial Officer

June 22, 2012

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

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

Dear Mayor Gray and Chairman Mendelson:

I would like to inform you that the revenue estimates for FY 2012-FY 2016 remain unchanged from the February 2012 certification. Table 1 below shows the February estimate as adjusted for revenue changes supporting the FY 2013 budget.

Table 1: February 2012 Revenue with Budget Changes

	Estimate			**Projected**	
Local Source, General Fund Revenue Estimate ($ millions)	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
February 2012 Estimate	**$ 5,704.9**	**$ 5,763.0**	**$ 5,867.0**	**$ 6,007.1**	**$ 6,164.7**
FY 2013 Budget changes	18.8	102.1	90.0	88.1	85.9
February 2012 Estimate Adjusted for FY2013 Budget Changes	**$ 5,723.7**	**$ 5,865.1**	**$ 5,957.0**	**$ 6,095.2**	**$ 6,250.6**
% change annual	***6.2%***	*2.5%*	*1.6%*	*2.3%*	*2.5%*

Overview

Since the February revenue certification, uncertainty about the national economic outlook has soared because of the slowing national recovery, an intensifying European debt crisis, and volatile oil prices. Moreover, if the Bush-era tax cuts expire at the end of the year and automatic spending cuts begin next January, this so-called "fiscal cliff" together with a stalling economic recovery, could tip the U.S. economy into another recession. Furthermore, the ongoing debate over the appropriate level of debt and expenditures continues to limit the Federal government options for a policy response to a national recession.

Against this gloomy U.S. economic backdrop, the District has been faring relatively well, with private sector employment growth offsetting declines in government employment. While any deterioration in the national economy will certainly reduce revenue flows to the District, the latest report of tax collections for the current fiscal year shows that revenue growth through May is in line with the February forecast. A steeper than expected drop in collections from the deed recordation and transfer taxes has been largely offset by strong growth in collections from the general sales and use tax. For fiscal year 2013 and beyond, the deteriorating national economic outlook is a cause for concern, but the February revenue forecast was already based on an assumption of weak national economic growth and included the effects of federal sequestration on the District's finances.

Revenue Highlights

Although there is no reason to change the revenue estimate at this time, there are some notable trends in particular tax sources. In general, collections for most tax sources are performing in line with the February forecast. The May cash collections report shows that total tax collections year-to-date are about 7.7 percent higher than the same period last year compared to the estimated increase of 6.4 percent. But the report overstates the growth in tax collections because of a delay by the Real Property Tax Appeals Commission (formerly the Board of Real Property Assessment Appeals) in deciding on commercial real property assessment appeals. In previous years, collections for first half billing included reductions in payments from successful appeals for both the residential and commercial sectors; this year the first half billing reflects only reductions for successful residential appeals. As a result, lower assessments from successful commercial real property appeals will reduce real property tax collections in the second half billing, and are expected to bring the tax collections in line with the February estimate.

As mentioned previously, one area of weakness in the tax collections data is collections from deed recordation and transfer taxes. The sale of several large high-priced properties last year suggests that fiscal year 2011 was a peak for deed taxes collections. Thus, the February estimate forecasted a decline of about 4 percent in revenue for the current fiscal year. But the May cash collections report shows that year-to-date collections have fallen almost 14 percent and are expected to finish the year between 10 and 15 percent below fiscal year 2011. According to CoStar, a firm that tracks commercial real estate trends, the number of sales of large commercial properties in the District through May is down about 18 percent from last year. The weakness in collections from deed taxes are largely offset by strong growth in collections from sales and use tax. Sales and use tax collections through May grew 8.8 percent compared to a forecasted growth of 3.1 percent.

National and Regional Economies

Recent data on the national economy suggest a stalling economic recovery. Gross domestic product (GDP) rose less than 2 percent in the first quarter, below most estimates, and most economic forecasts expect sluggish economic growth for the remainder of 2012.

- U.S. employment added 1.8 million jobs (1.4 percent) from May 2011 to May 2012, but was still 4.9 million (3.6 percent) below the number of jobs at the start of the recession. Public sector employment—federal, state and local—has declined seven months in a row.

- The U.S. unemployment rate (seasonally adjusted) was 8.2 percent in May, about where it has been since January 2012.

- U.S. Personal Income in the March quarter was 2.9 percent above a year ago.

- The S & P 500 stock market index in May was 3.5 percent below its level 2 months ago, and essentially at the same level as a year ago. It continues to be volatile in June.

- In the past few months, the regional economy has performed well. In the three-month period ending April, the region gained 35,500 (1.2 percent) wage and salary jobs compared to a year earlier; all the gain was in the private sector.

- The metropolitan area unemployment rate was 5.5 percent in May, little changed from December (not seasonally adjusted).

The District Economy

The District's economy remains in a holding pattern, caught between slowing on the federal side and very modest growth in the private sector.

- In April, there were 12,700 (1.8 percent) more wage and salary jobs located in the District than a year earlier, all in the private sector. Employment services, education, health and hospitality jobs gained the most. Government jobs continue to decline and are 3,100 lower than a year ago.

- District resident employment for the three-month period ending May was 7,085 (2.2 percent) more than a year earlier. The unemployment rate declined to 9.3 percent (seasonally adjusted rate), down from the high of 10.5 percent last summer.

- Wages earned in the District of Columbia grew 4.4 percent in the December 2011 quarter compared to the same quarter a year ago. Personal Income was 5.8 percent higher.

- Single family sales for the three-month period ending May 2012 were down 7.3 percent from a year ago, but the average selling price is 12.3 percent above last year. Growth was driven by homes priced at $1 million and higher, the sales of which grew 15.3 percent.

- Condominium sales were up 15.1 percent and the average price was up 4.3 percent, the third month in a row of positive price increases.

- The value of all home sale contracts for the three-month period ending May was 9.4 percent more than a year ago.

- In the quarter ending March 2012, occupied office space rose by 0.3 percent from the prior year and the commercial office vacancy rate fell to 8.9 percent (including sublet), still well below the metropolitan area average of 12.5 percent. An additional 3.3 million square feet are expected to be added to inventory over the next two years, but the District's vacancy rate will be 9.7 percent.

- Tourism has been mixed. For the three-month period ending April, the average room-rate for hotels increased 0.3 percent, while the number of hotel room-days sold was down 0.5 percent. Revenues from room sales were down 0.2 percent. For the three-month period ending April, employment in retail was up 0.2 percent, restaurant employment was up 3.2 percent and hotel employment was up 4.9 percent.

Outlook and Risks

The threat of federal cutbacks continues to pose the greatest risk to the District's economic and fiscal outlook. Federal government expansion cushioned the District and the metropolitan area economies from the worst effects of the recession over the past four years. The federal government will no doubt continue to anchor the District's economy, but given the current federal budget scenarios and recent contraction in federal employment, it can no longer be counted on to be a source of growth. The federal sequestration, if implemented in its current form, will have a severe impact on the District's economy and finances. Although the February revenue estimate included the impact of federal sequestration on the District, the estimate is based on one particular scenario. If the federal cutbacks are more severe than the scenario assumes, the fiscal outlook would worsen. On the other hand, if the federal government adopts a budget with less severe cuts than assumed here, the District's fiscal outlook projections would improve.

If you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

Natwar M. Gandhi

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