PUBLIC OVERSIGHT HEARING

ON

CAPITAL IMPROVEMENTS

Before the
Committee of the Whole, Council of the District of Columbia
The Honorable Vincent C. Gray, Chairman

Committee on Health, Council of the District of Columbia
The Honorable David A. Catania, Chairperson

Committee on Human Services, Council of the District of Columbia
The Honorable Tommy Wells, Chairperson

February 1, 2008, 10:00 a.m.
Council Chamber, John A. Wilson Building

Testimony of
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Natwar M. Gandhi
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Good morning, Chairman Gray, Chairperson Catania, Chairperson Wells, and members of the Committees. My name is Jim Spaulding, and I am the Acting Associate Deputy Chief Financial Officer for the Office of Budget and Planning (OBP). With me today is Mike Teller, Chief Information Officer for the Office of the Chief Financial Officer (OCFO). I am pleased to appear before you today to present testimony on the status of the District of Columbia's Capital Improvements Program. In my testimony, I will provide an update on the Capital Improvements Program, discuss the past deficit in the General Capital Improvements Fund and our progress toward eliminating it, and outline steps we are taking to improve management of the capital program in the future. Mr. Teller will subsequently present testimony on the status of the OCFO's capital projects.

Current Status of the Capital Improvements Program

The District's capital expenditures have increased in each of the past 2 fiscal years. Preliminary FY 2007 capital expenditure figures show that the District spent $1.06 billion, an increase of $165 million over the FY 2006 figure of $893 million. Even when spending on the baseball stadium is not included, capital expenditures have been increasing. Capital financing has also increased over the past 2 years, with larger General Obligation (G.O.) bond issuances for the general capital program as well as for specific large-scale projects, and increased use of pay-as-you-go (PAYGO) financing for capital. I will present more specific results for Fiscal Years 2006 and 2007 later in this statement. Note that all FY 2007 figures in my statement today are preliminary, pending finalization and release of the FY 2007 Comprehensive Annual Financial Report.

The District continues to benefit from improvements to its bond rating. In 2007, two of the three rating agencies upgraded the District's G.O. bond ratings, producing the current ratings of A1, A+, and A+ by Moody's, Standard & Poor's and Fitch Ratings, respectively. The upgrades in the bond ratings by these agencies have made the District's bonds more marketable, hence resulting in a lower cost of capital to the District.

However, borrowing constraints continue to affect the District's capital program, despite the recent success the District has experienced with our improved bond rating. The District has very high debt ratios relative to other jurisdictions of comparable size. Debt service is anticipated to reach 12 percent of the District's operating budget by FY 2010, reaching the maximum level recommended by the Chief Financial Officer in his June 20, 2007 letter to the Mayor and Council. In addition, our outstanding tax-supported debt per capita is expected to surpass

$10,000, one of highest figures in the country and more than twice the average of other major cities.

These measures reflect some large amounts borrowed for the following purposes since the beginning of FY 2006:

- A new baseball stadium ($535 million), and
- A new mental health hospital and a Department of Motor Vehicles building ($197 million).

In addition, borrowing has begun and will continue for several other large projects:

- Schools modernization ($150 million over 2 years),
- Two new Government Centers office buildings ($200 million over 3 years),
- A Consolidated Forensics Lab ($150 million over 3 years), and
- A new 11th Street bridge over the Anacostia River ($200 million over 3 years).

Finally, activities outside of the capital budget, such as (1) Tax Increment Financing and (2) borrowing based on Payments-in-Lieu-of-Taxes, also add to the District’s total outstanding debt.

Each of the bond rating agencies has indicated that they consider the District's debt burden to be high, and they factor this into their rating decisions on the District's bonds. Given the amount of outstanding debt and plans already made for future borrowing, the Chief Financial Officer has recommended a borrowing limit of $400 million per year for G.O. bonds related to new capital expenditures going forward, the same figure that has been budgeted for the past few years.

Managing the Deficit in the General Capital Improvements Fund

As OBP has testified on several occasions, the District's General Capital Improvements Fund (the "capital fund") was in deficit from FY 2001 through FY 2005. The FY 2004 deficit stood at $250 million, and at the end of FY 2005, it had improved slightly to $246 million. In Fiscal Years 2006 and 2007, the deficit turned into a large surplus. While this turnaround was partly a result of decisions made by the Mayor and Council to address the deficit, it was also the result of several large borrowings whose proceeds have not yet been spent. As District agencies spend these proceeds in coming years, this portion of the surplus will disappear. The Chief Financial Officer's management goal is to balance the capital fund on a long-term basis.

Preliminary FY 2007 figures show a positive capital fund balance of about $712 million, a turnaround of nearly $1 billion from the negative $246 million capital fund balance of 2 years ago (see table 1). As we testified last year, the FY 2006 turnaround was primarily the result of borrowing of Certificates of Participation (COPs) and tobacco revenue bonds, with little spending of the proceeds in that year. Similarly, in FY 2007, there were several large sources of revenues with little FY 2007 spending. For example, the District transferred $100 million of PAYGO revenue to the capital fund for schools construction and also borrowed $60 million in the first installment of the additional FY 2006 bond funds for schools. However, D.C. Public Schools did not have access to the budget for these funds until April of 2007 because of legislative restrictions, and little was spent by the end of FY 2007. The District also borrowed $64 million against future bus shelter revenues for the Great Streets programs. Thus, about $536 million of the FY 2007 year-end capital fund balance is the unspent proceeds of FY 2006 COPs and tobacco bonds and FY 2007 school modernization and Great Streets financing. We anticipate most of these balances being spent within the next 2 years, which will rapidly reduce the capital fund balance.

Table 1: FY 2006 and FY 2007 Performance, General Capital Improvements Fund

(Dollars in thousands)	Total, Capital Fund	Components of Capital Fund				
		FY 2006 Tobacco Proceeds	FY 2006 COPs Proceeds	FY 2007 School Financings	FY 2007 Great Streets Financing	All Other Sources
FY 2005 Ending Position	**(246,362)**	**0**	**0**	**0**	**0**	**(246,362)**
FY 2006 Revenues	1,295,380	245,260	196,879	0	0	853,241
FY 2006 Expenditures	652,198	0	15,363	0	0	636,835
FY 2006 Surplus	643,182	245,260	181,516	0	0	216,406
FY 2006 Ending Position	**396,820**	**245,260**	**181,516**	**0**	**0**	**(29,956)**
FY 2007 Revenues (preliminary)	1,083,230	0	0	160,000	64,000	859,230
FY 2007 Expenditures (preliminary)	768,523	49,000	41,159	23,176	1,674	653,514
FY 2007 Surplus (preliminary)	314,707	(49,000)	(41,159)	136,824	62,326	205,716
FY 2007 Ending Position (preliminary)	**711,527**	**196,260**	**140,357**	**136,824**	**62,326**	**175,760**

Notes:
"Other Fund Components" include federal funds, master equipment lease proceeds, FY 2003 Certificates of Participation, Rights-of-Way fees, and several other sources of financing.
This table includes only the General Capital Improvements Fund and thus omits capital revenues and expenditures related to the Ballpark Fund and the (Local) Highway Trust Fund.

The deficit management plan put in place several years ago by the Mayor and Council involved adding resources to the capital fund to offset prior spending, and then managing capital spending to stay within new revenues going forward. The FY 2006 budget used $54 million of fund balance from the General Fund to reduce the capital fund deficit, and beginning in FY 2007, the District has borrowed $50 million more in G.O. bonds each year than it has awarded in new budget allotments. Continuing this plan through FY 2011, and managing spending carefully to stay within available resources, will ensure the long-term balance of the capital fund.

Further Improvements in Capital Budget Management

OBP has strengthened central budget office oversight and internal control functions with regard to the capital program. As we have stated in the past, we want to ensure that the District's capital budget formulation and execution always stand up to our rigorous budgeting and accounting principles and standards.

There are several areas in which we see a need for increased attention:

1. Operating budget effects from completed capital programs. When capital projects are completed and come on-line, the operating budget often feels the impact. The impact could be cost savings—for example, systematic window replacement in a government building might save on utility costs. However, the impact often means increased costs. A new recreation center will require expenditures for both personal services (staffing) and nonpersonal services (fixed costs) in future years. Even if it is a replacement facility, rather than a brand new facility, there might be an incremental increase in these costs if the replacement facility is larger or offers more services.

We are striving to obtain estimates of such costs from agencies for their proposed new capital projects. When the Mayor and Council approve a new project, they should be aware of the possible future impact on the operating budget. Reviewers of our budget documents for the Government Finance Officers Association have also asked us to include such information. Ideally, we would like to total these estimates for all projects in the capital plan and include this total in the District's financial plan. But we have much work to do before we are able to provide a reasonable city-wide estimate.

2. Complete the ongoing corrections to capital budgets in the financial system. As we have testified in the past, some project budgets in the System of Accounting and Reporting (SOAR) are incorrect—that is, the project budgets do not match the approved budget level as justified by (1) prior year budget books and (2) approved reprogrammings and other budget changes, such as PAYGO allocations in a supplemental appropriation. In the past 15 months, we have fully reconciled the capital budget for all projects in D.C. Public Schools and the Fire and Emergency Medical Services Department. We have also nearly reached agreement with required changes to SOAR for the Department of Parks and Recreation, the Office of the Chief Technology Officer, the Office of Property Management, and the Department of Corrections. These represent some of the largest capital agencies in the District. We will continue this work to complete the corrections with these agencies and all others. As we have discussed with your staff, some of these agencies will require reprogrammings as the corrections are being made, in cases where agencies have relied on misleading SOAR data and now need to realign their budgets to their ongoing needs.

3. Capital-funded full-time equivalent (FTE) positions. OBP plans to enhance the ability to track capital-funded FTEs. Currently, some agencies pay employees out of capital funds, but all capital is budgeted in non-personal services. Different agencies then account for the actual expenditures on salaries and fringe benefits in different ways through journal vouchers. Our goals are to (1) standardize the accounting for capital-funded FTEs, (2) budget for personal services within capital project budgets for the first time in FY 2009, and (3) beginning in FY 2010, incorporate capital-funded FTEs into the District's position budgeting system and have their salaries recorded directly into the capital projects.

4. Enhance our technological capabilities. The OCFO continues to make continual incremental maintenance enhancements to our major financial systems such as SOAR, the accounting system of record; the Budget Formulation Application; and both EIS and CFO$ource, our management tools for analyzing budgets and expenditures. In particular, we are always looking for additional enhancements to management and reporting capabilities, and we have been gratified by the active participation of your staff as we discuss improvements going forward. As our CIO will testify, while we are working on operational improvements for all these systems, we are also actively collecting input so that we can define the critical improvements we will need to see in the eventual successor financial systems.

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The District's capital needs exceed our available resources to finance and to pay debt service on the financing of such needs, as the Chief Financial Officer has often noted in his discussion of the city's structural imbalance. Managing the District's capital program to deliver necessary capital improvements in so many of the city's areas of need, while working within the borrowing constraints we face and gradually reducing the accumulated deficit, is a major challenge for the Mayor, the Council, and the CFO. As always, the Office of Budget and Planning is committed to working collaboratively with the Council and Mayor, other stakeholders, and agencies that implement capital projects to improve the effective and efficient operations of the capital program.

Thank you for the opportunity to testify today. I will be happy to respond to any questions that you may have.