BUDGET HEARING

FY 2008 BUDGET REQUEST FOR DEBT SERVICE AND RETIREE BENEFITS

Before the

Committee of the Whole
Council of the District of Columbia

The Honorable Vincent C. Gray, Chairman

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Council Chambers

Testimony of
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Good afternoon, Chairman Gray and members of the Committee of the Whole. I am Lasana Mack, Deputy Chief Financial Officer and Treasurer in the Office of the Chief Financial Officer, Office of Finance and Treasury. In my testimony today, I will briefly discuss the proposed FY 2010 debt service budgets for short-term and long-term debt, including General Obligation Bonds and Notes, Income Tax Secured Revenue Bonds, Other Revenue Bonds, Certificates of Participation, Master Equipment Lease/Purchase Program, and Bond Issuance Costs. In addition, I will briefly address the funding of the District's Other Post Employment Benefits (OPEB).

<u>Short-term Debt Service (ZA0)</u>

The proposed FY 2010 budget for short-term debt service is $9 million, to accommodate short-term borrowing of an estimated $500 million to finance the District's FY 2010 seasonal cash flow needs. In FY 2009, such borrowing was $400 million, which will be repaid by September 30, 2009.

<u>Long-term Debt Service (DS0)</u>

The proposed FY 2010 debt service for long-term borrowing in this category totals $475.1 million on total projected long-term debt of approximately $5 billion. This represents an increase of approximately $15 million over the approved FY 2009 approved budget. This increase is attributable to debt service on new debt issued in FY 2009 and debt to be issued in FY 2010 to finance planned expenditures in the District's Capital Improvements Program.

The proposed FY 2010 debt service budget reflects the borrowing included in the proposed FY 2010 Capital Improvements Plan of $631 million, which includes borrowing for on-going general capital projects and also borrowing to support two major initiatives: Government Centers and Consolidated Laboratory Facility.

This borrowing is expected to be accomplished via the District's new borrowing mechanism, Income Tax Secured Revenue Bonds. I would like to take this opportunity to clarify certain facts associated with these bonds.

Mr. Chairman, for the record, the following are facts associated with the District's new Income Tax Secured Revenue Bonds:

- The District's issuance of income tax revenue bonds ("IT bonds") will not increase the District's overall cost of borrowing and will not harm the District's general obligation (GO) bonds (including currently outstanding GO bonds and any future issuances of GO bonds). In fact, in its rating report on the District's first IT bonds issuance, Moody's Investors Service plainly stated that the District's issuance of IT bonds "does not negatively affect [the] District's GO bonds."
- It is estimated that the District will save a total of $28 million in debt service over the course of the next four years as a result of issuing IT bonds as opposed to GO bonds, based on the higher ratings and corresponding lower interest rates and bond insurance costs associated with the IT bonds.
- Regarding the issue of why Moody's and Fitch rated the District's IT bonds AA, two notches below the AAA rating from Standard and Poor's—which, Mr. Chairman, is a question that you asked me at a prior hearing—the crux of the answer is that each of the rating

agencies has its own distinct methodology for rating bonds. Both Moody’s and Fitch cited strengths in the credit and structure associated with the District’s Income Tax Bonds that allowed them to achieve a rating higher than the District’s GO bonds. Even though it’s lower than AAA, AA is still a very good rating.

- Having said that, to attempt to explain it further, it appears that, in general, Standard and Poor’s places a higher value than the other two rating agencies on this type of structured revenue bond with a high coverage ratio and strong legal protections. This has been seen on other bonds of this nature, including other income tax bonds, which have been rated AAA by Standard and Poor’s and AA by Moody’s and/or Fitch. Beyond that, it is really difficult to speak for the rating agencies other than to say that based on each of their distinct methodologies, each of their ratings represents each of their independent views of the relative strength of the combination of factors that they analyze. It is somewhat analogous to two (or three) different professional investment managers being willing to pay differing prices for a particular stock or bond, or two different professional appraisers assigning differing values to a piece of property, based on their distinct methodologies for analyzing and valuing these assets and their associated specifications, statistics and variables.
- Finally, in terms of fact clarification regarding the IT bonds, the Trustee bank associated with the bonds acts as the bondholders’ agent, and is legally bound to use the collected income tax revenues only to pay the bondholders or transfer funds to the District, pursuant to specific bond covenants and instructions. All

of the rating agencies cited the strong legal protections and mechanics associated with the Trustee arrangement as positive attributes of the structure of the bonds.

- In summary, the District's issuance of Income Tax Secured Revenue Bonds was, and will be going forward, a judicious, resourceful and prudent utilization of the financial tools available to the District in order to produce real debt service savings for District taxpayers, over the short term and the longer term.

Certificates of Participation (CP0)

The District's Certificates of Participation (COPs) budget category includes debt service on three series of COPs, one issued to finance the land for the One Judiciary Square facility, one issued to finance the DC-Net/Unified Communications Center project and the third issued to finance the new St. Elizabeth's Hospital and new DMV facility. The FY 2010 budget request of $32.3 million for this category is approximately the same as the approved FY 2009 level.

Master Equipment Lease/Purchase Program (ELO)

The FY 2010 budget request for debt service associated with the District's Master Equipment Lease/Purchase Program is $46.2 million, which is approximately $3.2 million higher than the FY 2009 level. This increase is attributable to incremental planned financing by agencies that utilize this program.

Bond Issuance Costs (ZB0)

The proposed FY 2009 budget for bond issuance costs is $15 million. It should be noted that this budget category has a corresponding revenue component (for which the source is bond proceeds, which is sized to match the amount actually needed), so the level of funding for this budget category produces no net effect on the budget. This request represents a decrease of $5 million compared to the approved FY 2009 funding level.

School Modernization Fund (SM0)

The proposed FY 2010 budget for the Schools Modernization Fund is $8.6 million. This represents the same funding level as the approved FY 2009 amount. The proposed FY 2010 budget for this agency represents the debt service on the $150 million of borrowing that occurred pursuant to the legislation that produced this budget category.

Repayment of Revenue Bonds (DT0)

The proposed FY 2010 budget for this agency is $6 million. This budget request is equal to the approved FY 2009 funding level. The borrowing authorized in this category is for projects to be financed by revenues allocated to the Housing Production Trust Fund. Such financing is expected to occur in increments, gradually increasing the debt service in this category over time. Any debt service budget authority in this category that is not utilized in a given fiscal year stays within the Housing Production Trust Fund and is available to be used for the designated purposes of that Fund.

Other Post-Employment Benefits (OPEB)

The proposed FY 2010 budget contains $88.7 million in funding to address the District's cost of health insurance and other benefits for retirees. The proposed FY 2010 budget for this category represents an increase of $7.6

million compared to the approved FY 2009 funding level. This funding level is based on the Mayor's proposed change to a years-of-service-based level of benefits to be provided by the District. Council has not yet taken action on this proposed legislation.

Chairman Gray, this concludes my testimony. I am prepared to address any questions that you or other members of the Committee may have.