

February 28, 2002

Council of the District of Columbia

**PUBLIC OVERSIGHT HEARING ON THE PERFORMANCE OF THE OFFICE OF THE
CHIEF FINANCIAL OFFICER DURING FISCAL YEARS 2001 AND 2002**

**Testimony of Julia Friedman, Deputy Chief Financial Officer, Office of Research
and Analysis, before the Committee on Finance and Revenue**

Good morning, Mr. Chairman and Members of the Committee. I am Julia Friedman, Deputy Chief Financial Officer for Research and Analysis. I am pleased to appear before you today to present testimony on the Fiscal Year 2001 and Fiscal Year 2002 expenditures and performance for the Office of Research and Analysis (ORA).

The Office of Research and Analysis is a relatively new organization, established in June 2000 by the Chief Financial Officer. ORA was created from elements of other agencies and, just a year ago in February 2001, was unified in one location at 441 4th Street, NW, Suite 400. Since then, ORA has grown in capability, morale and staffing, and now serves as an extremely valuable resource for the Office of the Chief Financial Officer (OCFO), the District government and external parties.

The mission of ORA is to provide innovative and sophisticated research that will enhance and assist the decision-making and performance capacity of the Office of the Chief Financial Officer, as well as the Mayor, the Council of the District of Columbia, the Congress and others who are involved in the policies and administration of the District of Columbia.

I am pleased to report to you on the progress we have made during the past year in organizing and developing our research and analytic capacity, and to discuss our goals for Fiscal Year 2002.

Advancing the Mission of ORA in FY 2001

1. Creating the Organization

After a year of transition in its new location, ORA has become a successful element of the Office of the Chief Financial Officer. It is a resource that can provide professional, competent answers to complex financial questions.

In Fiscal Year 2001, the Office of Research and Analysis had a budget of \$3.6 million and a staffing level of 42 employees. Because ORA was a new agency, it took most of FY 2001 to hire qualified specialists to reach this level. The Fiscal Year 2002 budget for ORA is \$3.4 million, a slight decrease from FY 2001, with the same staffing level. Operating expenses through January 2002 total \$838,000, or 25 percent of our budget. We expect to end the fiscal year within our approved budget.

2. Analyzing the Economy and Economic Development

One of the key functions of ORA is to provide up-to-date research and analysis of the District's economic base and economic development issues. In October 2000, ORA initiated a monthly publication of "DC Economic Indicators," which tracks DC employment, jobs, income, tax revenue, housing sales and other indicators and compares them with national indicators. This report now appears monthly on the CFO Web site and has become widely used by the District government and the public.

ORA tracks and models the DC economy, providing projections for revenue estimations and economic development projects. In FY 2001, for example, ORA supported the OCFO in extensive financial analysis and negotiation related to three TIF projects and proposals for a fourth project. The financial analysis support for the city's economic development projects is an on-going effort and will continue in FY 2002.

ORA also convenes and staffs technical meetings for the CFO and, when requested, for the Mayor. During FY 2001, these included the CFO's Advisory Group, the CFO's Business Advisory Group, the CFO's Technical Revenue Estimating Advisory Group, and the Mayor's Task Force on the Impact of

Terrorism on the DC Economy. ORA contributes to and attends most meetings with members of bond rating agencies and underwriters.

3. Grants Management and Development

In addition to research and analysis, ORA is responsible for tracking and efficiently managing grant spending, processing modifications to grant budget authority, and working with agency-level staff to ensure that grant funded programs are available and effectively utilized to serve the citizens of the District. During FY 2001, ORA handled 23 grant competitions for agencies, which resulted in making approximately \$30 million available in grant funds for the benefit of District residents.

ORA made significant improvements in monitoring and managing grant spending. In FY 2001, we processed 633 modifications to grant budget authority, which resulted in \$307 million being added through grants to the budget approved by Congress. A fourth quarter effort by ORA helped agencies minimize grants lapse in FY 2001, so that only one-third of one percent of all federal grant money, or \$4.3 million, was lost by not being spent or committed on a timely basis. We are taking additional steps to address the issue of lapsed funds in FY 2002.

4. Building Research Capacity

ORA has taken the lead in research, analysis, and the development of important databases essential to the analysis of District budget, policy and financial issues. During FY 2001, ORA improved its capacity in three key areas: (1) development of fiscal impact statements, (2) long-range financial planning and (3) revenue estimation.

Fiscal impact statements and special studies. A major responsibility of ORA is the preparation of fiscal impact statements, i.e., analysis of the impact of proposed policy changes on the District's expenditures and revenues. The purpose of the analysis is to estimate the net cost to the government of achieving policy goals, so that proposed changes may be compared to other goals in allocating a finite budget. In FY 2001, a unit dedicated to analyzing the fiscal impact of policy proposals was established in ORA. One innovation in the unit is the assignment of analysts to work on specific subject matter areas with committees and agencies. We expect this approach to help expedite the preparation and delivery of fiscal impact statements. During FY 2001, 168 fiscal impact statements were completed for use by the Council of the District of Columbia and by the Mayor.

ORA also provides research and analytical support for reviews and studies in many other policy areas. Examples in FY 2001 included work on issues of financial structural imbalance, research on the impact of September 11 on the local economy, analyses of proposals for building affordable housing in downtown Washington, and research on tax expenditures.

Long-term financial planning. In FY 2001, the District's five-year financial plan – an important tool for measuring and insuring the long-term financial health of the District – became the responsibility of ORA. This multi-year plan is used by the OCFO and other District financial managers throughout the year to track and assess the impact of legislative proposals, programmatic initiatives, and economic changes on the District's fiscal status. In preparing the FY 2001 plan, ORA worked closely with other agencies within the OCFO, as well as with representatives of the Council and Mayor's office, to ensure the accuracy and quality of this important document. This task was made more complex in FY 2001 by the need to integrate cash and accrual accounting and budget concepts within one document.

Revenue estimation. One of the most critical responsibilities of ORA is the preparation of revenue estimates. Revenue forecasting is difficult under the best of circumstances. In the District, it is even more complicated because of the long, 18-month lead time between the time the budget is prepared and the time it actually goes into effect. Other factors also complicate this issue, particularly the weak connection between the District's tax base and its economic activity. Accordingly, during FY 2001 ORA took steps to improve its econometric forecasting models, acquired a more sophisticated data warehouse, and developed better links to the local business community and regional experts. These steps will aid our ability to more closely track District revenues and improve the quality of our projections.

The local source general fund revenue estimate for FY 2003 was certified by the CFO on Feb. 26, 2002, and transmitted to the Chairman of the Council of the District of Columbia and the Mayor. That estimate is \$3,595.7 million after adjusting for the Tax Parity Act (with the previously scheduled FY 2002 changes as well as the FY 2003 changes implemented in FY 2003) and for the new Housing Act and other legislative changes. In addition there will be \$33 million in federal projects funded with federal money in FY 2003. Documents containing these estimates are attached to this testimony. Grant, private, and other non-general fund revenues will be certified in May, after the FY 2003 budget is complete. In November we expect to issue and certify a revised revenue estimate.

Estimating assumptions also are attached. They indicate that the District's economy will begin a slow recovery from the mild recession in the summer of 2002. Overall there is a 1.6 percent drop in resident employment in FY 2002 (on an annualized basis) and 1.7 percent growth in FY 2003, recovering the losses of FY 2002. Total employment in DC grows 0.3 percent in FY 2002 and 0.6 percent in FY 2003. The financial markets that have played so large a role in revenue generation in recent years are forecast to drop about 6 percent in FY 2002 and rebound 5.5 percent in FY 2003 (as measured by the Standard & Poor's 500 stock fund index). The markets for housing and commercial property soften but remain strong by historic standards through the period.

The estimate also assumes that no additional terrorist attacks occur in a manner that disrupts the DC economy. While the direct impact of September 11 continues to fade, the hospitality industry is forecast to operate at normal capacity levels but with reduced room rates. The opening of the new convention center in March 2003 adds to sales and use tax revenue. Federal spending for emergency preparedness in the metropolitan area is expected to help the District primarily by helping to sustain demand for office space in downtown.

The revenue estimates for FY 2003 were prepared under the leadership of Dr. Fitzroy Lee, who joined ORA last July. The addition of Dr. Lee upgrades our revenue estimating capacity. His attention is focused in two directions – first, improving our data management and quality, a particularly important function as new data from the Integrated Tax System begin to come online. Second, he is testing and expanding the revenue estimating models that were already in use at ORA. As part of this process, we contracted with an external auditing firm to review our data and estimating methodologies and their implementation, and to suggest changes as appropriate. Their overall conclusion is that ORA uses sound methodologies and implements them competently.

The lead-time of 18 to 20 months between original revenue estimates for DC budgets and completion of the budget cycle inevitably results in substantial variation between original estimates and actual revenues. This variation could mean either substantial surpluses for the District or severe budget cutting to avoid substantial deficits. Because of the very difficult problem of managing a budget deficit, the OCFO attempts to estimate so that a deficit is less likely than a surplus. In FY 2002, DC's more conservative approach has served us well. While DC currently faces a \$40 million potential revenue shortfall in FY 2002, our deficit would be \$117 million using Maryland's higher original assumptions, \$230 million if like Virginia's, and \$495 million when compared to the CBO's.

Looking Ahead in Fiscal Year 2002

Our goal for FY 2002 is to build on the foundation laid during the past year in providing timely and effective research and analysis on District financial and tax policy issues. To that end, we have established operational goals and objectives to further improve our research and analytic capacity and service, and also to ensure that the District's grant funded programs are available and effectively utilized. Key areas we will address include the following:

- (1) We will continue work now underway to develop more accurate tax databases. This will support better economic and revenue forecasting models.
- (2) We will provide fiscal impact statements as timely as possible and will make them more accessible. Within a few weeks, impact statements from Council Session 14 will be posted on the CFO Web site so that they are easily retrievable. We have prepared a monthly

summary report showing the aggregate fiscal impact of legislation enacted since the FY 2002 Budget was submitted to Congress; this will be on the Web site soon. In the first five months of FY 2002, a total of 80 fiscal impact statements have been transmitted to the Council.

- (3) For FY 2002, we will increase our efforts to reduce the amount of federal grant funds lost due to lapse. All instances of potential lapse will be addressed jointly by ORA and agency CFO staff, with a strategy developed in each case to avoid the potential for lost funds.
- (4) We will continue to utilize our resources to assist city agencies in practicing sound grants management through grant competitions. ORA indirectly serves DC citizens by subgranting federal funds awarded to city agencies. In the first two quarters of FY 2002, we have assisted with granting approximately \$6 million in grant funds to community-based organizations. We also provide technical assistance to the subgrantees by monitoring the grant programs to ensure compliance with federal and District grant regulations.
- (5) Research in tax policy and economic analysis will increase in FY 2002. We are expanding our study of tax expenditures, and this will be included in the FY 2003 Budget Submission to Congress. We will continue to issue our reports on cash collections and economic indicators on a timely basis, so that these reports are routinely available to the public by the end of the month following the month being reported. These reports are now published monthly on the CFO Web site. We also will continue to publish our reports comparing District tax rates and tax burdens to the 50 states and other large cities nationwide, as well as to other jurisdictions in the Washington metropolitan area.
- (6) Finally, as we continue our work on the District's Financial Plan, we will seek ways to make it more useful to financial managers, and to establish criteria to use in measuring financial management benchmarks.

Chairman Evans, I thank you and the Members of the Committee for the opportunity to testify today. I will be happy to answer any questions you might have.

ATTACHMENT 1

FY 2000 and 2001 Actual, FY 2002 - 2006 Estimates and Projections (thousands of dollars)							
Revenue Source	FY 2000 Actual	FY 2001 Actual	FY 2002 Rev. (2/02)	FY 2003 Orig. (2/02)	FY 2004 Proj.	FY 2005 Proj.	FY 2006 Proj.
Property	692,781	707,423	774,623	824,587	855,722	871,862	888,724
Sales	644,337	677,139	687,154	703,880	736,305	761,465	788,861
Income	1,338,564	1,400,237	1,312,179	1,365,501	1,340,221	1,389,903	1,443,742
Gross Rec.	212,011	233,740	236,761	244,337	249,816	258,228	266,526
Other Taxes	141,610	190,734	172,741	179,468	168,998	164,423	177,179
TOTAL TAXES	3,029,303	3,209,273	3,183,458	3,317,773	3,351,062	3,445,881	3,565,032
TOTAL NON-TAX	236,385	255,605	223,341	223,613	230,672	239,872	239,624
Lottery	69,450	83,925	70,000	72,900	73,800	74,600	74,600
GENERAL FUND*	3,335,138	3,548,803	3,476,799	3,614,286	3,655,534	3,760,353	3,879,255
Legislative Reductions	0	0	(13,500)	(18,571)	(20,988)	(19,789)	(19,891)
Tax Parity Adjustment	0	0	34,000	0	0	0	0
ADJUSTED GENERAL FUND*	3,335,138	3,548,803	3,497,299	3,595,715	3,634,546	3,740,564	3,859,364
With Adjustments							
Federal Project Funds	23,576	36,683	38,193	33,000	0	0	0