PUBLIC OVERSIGHT HEARING ON

THE FISCAL YEAR 2003 AND 2004 SPENDING AND PERFORMANCE BY THE OFFICE OF BUDGET AND PLANNING, INCLUDING RESERVES, DEBT SERVICE, TOBACCO TRANSFER, CERTIFICATES OF PARTICIPATION, AND THE TAX INCREMENT FINANCING PROGRAM

Before the

Committee of the Whole
Council of the District of Columbia

The Honorable Linda W. Cropp, Chairman

February 17, 2004, 2:45 p.m.
Council Chamber, John A. Wilson Building

Testimony of
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Office of Finance and Treasury

Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

Good afternoon Chairman Cropp and members of the Committee of the Whole. My name is N. Anthony Calhoun, and I am the District's treasurer and deputy chief financial officer for finance and treasury. I am here to present testimony regarding the District's debt service, certificates of participation, tobacco transfer, cash reserves, and tax increment financing (TIF) for fiscal years 2003 and 2004. I am accompanied by Lasana Mack, associate treasurer, who is here to assist me in answering any questions that the committee might have at the conclusion of my testimony.

Long-term Debt Service

Total FY 2003 debt service expenditures on the District's long-term general obligation bonds were approximately $7.5 million below the original budget and $2.1 million below the revised budget. This was due to the refunding (refinancing) of a portion of the District's outstanding bonds in FY 2003 at lower interest rates, which produced debt service savings in FY 2003, and the continued very low interest rates on the District's variable-rate bonds.

It should be noted that the District received an upgrade in the credit rating on its outstanding general obligation bonds in FY 2003, from BBB+ to A-, by both Standard and Poor's and Fitch rating agencies. This upgrade contributed to the District's ability to obtain low interest rates.

FY 2004 total long-term debt service is currently projected to be approximately $301.5 million, approximately $10 million below the FY 2004 budgeted amount of $311.5 million. This is a result of the continued record-low interest rates, which have again produced substantial savings, particularly on the District's variable-rate bonds.

This estimate includes the ability to absorb a modest increase in interest rates for the remainder of the fiscal year. If interest rates were to rise dramatically, this estimate could be exceeded.

Certificates of Participation

In FY 2003, principal and interest on the District's Certificates of Participation, issued to finance the land for the One Judiciary Square facility, totaled $2.3 million, which was $5.7 million below the original budget for this category. This was due to the refunding of this debt in FY 2003 at substantially lower interest rates, with the debt service savings from the refunding achieved in FY 2003 and FY 2004.

In FY 2004, the budget is $4.9 million, reflecting the FY 2004 debt service savings that resulted from the refunding. It is expected that the FY 2004 expenditures will be very close to the budgeted amount.

Tobacco Transfer

As you are aware, in FY 2001 the District of Columbia Tobacco Settlement Financing Corporation (the "Corporation") was established, and it issued $521 million of revenue bonds (the "Tobacco Bonds") backed by future tobacco settlement payments to the District from tobacco manufacturers.

The FY 2003 budget did not include the transfer of any funds to the District's Tobacco Trust Fund, since the Mayor and Council decided that all available tobacco funds would be used in the general fund budget. There were tobacco "residuals" (payments from the tobacco companies in excess of the amount needed for debt service on the Tobacco Bonds) in the amount of $5.1 million, which were transferred from the Corporation to the District and included in the District's general fund revenues.

The FY 2004 budget also does not include the transfer of any funds to the Tobacco Trust Fund. Due to the downgrade in the credit rating of one of the tobacco manufacturers, which is a “trapping event” in connection with the Tobacco Bonds, the District is not expected to receive any residuals in FY 2004.

Short-term Debt Service

In FY 2003, the District borrowed $150 million by issuing Tax Revenue Anticipation Notes. The variance between the original budget and the actuals in the “Interest on Short-term Borrowing” category is due to the fact that it was initially projected that the District would only need to borrow a minimal amount in short-term funds for FY 2003, and for a relatively short duration. However, as the fiscal year approached (after the budget was finalized), it became clear that with the large amount contributed to the District’s cash reserves at the end of FY 2002 and a few other changes in the District’s cash flows, the District would need to borrow more in FY 2003 and have it outstanding for a longer duration than initially projected. Funds were reprogrammed from another debt service category to cover this variance.

In FY 2004, the District borrowed $250 million by issuing Tax Revenue Anticipation Notes. It is expected that the expenditures will be approximately $500,000 below the budget of $3 million, due to the fact that the District was able to execute its FY 2004 short-term borrowing at a record-low interest rate.

Reserve Funds

In FY 2003, the District deposited an additional $5.1 million into the Cash Reserves (Emergency and Contingency Reserves) to maintain them at their required level of a combined 7 percent of local general fund expenditures, or $253.8 million. In FY 2004, it is expected that an additional $31.6 million will be deposited into the Cash Reserves to keep them in line with the requirement, bringing the total to $285.4 million. These Cash Reserves are viewed very favorably by the bond rating agencies and investors in the District's bonds as an indication of financial health, and were a positive factor in the rating agencies' decision to upgrade the rating on the District's bonds in 2003. However, the District's cash reserve requirements are among the most demanding of any jurisdiction in the country, and the Chief Financial Officer is preparing to propose adjustments to these requirements that will make them less stringent.

Tax Increment Financing

The TIF line item in the FY 2004 budget contains $1.94 million, which represents the amount that the District was required to budget as a reserve to cover debt service on the Gallery Place and Mandarin Hotel TIF bonds. It is expected that this amount will be expended on debt service on these bonds, as the incremental revenues from these projects are not expected to be at a sufficient level to provide for the debt service until FY 2005.

Chairman Cropp, members of the committee, that concludes my testimony. We are prepared to answer any questions that you may have.

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